MATTERS TO BE CONSIDERED:

Portion Open to the Public

1. Docket No. 88-16—Service Contracts—Petition for Reconsideration.

Portion Closed to the Public

Service Contract Docket No. 89-09—Asia North America Eastbound Rate Agreement Correction of Clerical Errors in Service Contract S.C. No. 1345/89.

CONTACT PERSON FOR MORE INFORMATION: Ronald D. Murphy, Assistant Secretary, (202) 523-5725.

Ronald D. Murphy,

Assistant Secretary.

[FR Doc. 89-16032 Filed 7-3-89; 2:54 pm]

BILLING CODE 6730-01-M

FEDERAL RESERVE SYSTEM BOARD OF GOVERNORS

"FEDERAL REGISTER" CITATION OF PREVIOUS ANNOUNCEMENT: 54 FR 27096, June 27, 1989.

PREVIOUSLY ANNOUNCED TIME AND DATE OF THE MEETING: 12:00 Noon, Monday, July 3, 1989.

CHANGES IN THE MEETING: Addition of the following closed item(s) to the meeting:

Consideration of legislation relating to banking structure.

CONTACT PERSON FOR MORE INFORMATION: Mr. Joseph R. Coyne, Assistant to the Board; (202) 452-3204.

Dated: July 3, 1989.

Jennifer J. Johnson,

Associate Secretary of the Board.

[FR Doc. 89-16035 Filed 7-3-89; 3:25 pm]

BILLING CODE 6210-01-M

INTERSTATE COMMERCE COMMISSION

TIME: AND DATE: 10:00 a.m., Thursday, July 13, 1989.

PLACE: Hearing Room A, Interstate Commerce Commission, 12th & Constitution Avenue, NW., Washington, DC 20423.

STATUS: Open Special Conference.

MATTERS TO BE DISCUSSED: FY 1991 Budget.

CONTACT PERSON FOR MORE INFORMATION: A Dennis Watson, Office of Government and Public Affairs, Telephone: (202) 275-7252.

Noreta R. McGee,

Secretary.

[FR Doc. 89-15681 Filed 6-29-89; 1:52 pm]

BILLING CODE 7035-01-M

RAILROAD RETIREMENT BOARD

Public Meeting

Notice is hereby given that the Railroad Retirement Board will hold a meeting on July 11, 1989, 9:00 a.m., at the Board's meeting room on the 8th floor of its headquarters building, 844 North Rush Street, Chicago, Illinois, 60611. The agenda for this meeting follows:

Portion Open to the Public

(1) Proposed Changes in the RUIA Regulations.

(2) Proposed Regulation, Part 327, Availability for Work.

(3) 20 CFR Part 255—Recovery of Overpayments.

(4) Recommendation for Accepting as Valid Delayed Registrations Made by Ron E. Walls.

(5) Discussion of Management Initiative Regarding Communications, Productivity and Training.

Portion Closed to the Public

(A) Appeal of Nonwaiver of Overpayment, Marjorie L. Miller.

(B) Appeal from Referee's Denial of Disability Annuity, John R. Rogers.

(C) Appeal from Referee's Denial of Sickness Benefits, Raymond J. Strycharz.

The person to contact for more information is Beatrice Ezerski, Secretary to the Board, COM No. 312-751-4920, FTS No. 386-4920.

Dated: June 30, 1989.

Beatrice Ezerski,

Secretary to the Board.

[FR Doc. 89-15969 Filed 7-3-89; 11:04 am]

BILLING CODE 7905-01-M

SECURITIES AND EXCHANGE COMMISSION

Agency Meeting

Notice is hereby given, pursuant to the provisions of the Government in the Sunshine Act, Pub. L. 94-409, that the Securities and Exchange Commission will hold the following meetings during the week of July 10, 1989.

A closed meeting will be held on Monday, July 10, 1989, at 9:30 a.m. An open meeting will be held on Monday, July 10, 1989, at 1:00 p.m., in Room 1C30.

The Commissioners, Counsel to the Commissioners, the Secretary to the Commission, and recording secretaries will attend the closed meeting. Certain staff members who are responsible for the calendared matters may also be present.

The General Counsel of the Commission, or his designee, has certified that, in his opinion, one or more of the exemptions set forth in 5 U.S.C. 552b(c)(4), (8), (9)(A) and (10) and 17 CFR 200.402(a)(4), (8), (9)(i) and (10), permit consideration of the scheduled matters at a closed meeting.

Commissioner Schapiro, as duty officer, voted to consider the items listed for the closed meeting in closed session.

The subject matter of the closed meeting scheduled for Monday, July 10, 1989, at 9:30 a.m., will be:

Institution of injunctive actions.

Institution of administrative proceedings of an enforcement nature.

Vacate injunctive actions.

The subject matter of the open meeting scheduled for Monday, July 10, 1989, at 1:00 p.m., will be:

1. Consideration of whether to publish for comment proposed regulations that would facilitate multijurisdictional offerings by U.S. and Canadian issuers. For further information, please contact Sara Hanks or William Haseltine at (202) 272-3246.

2. Consideration of whether to propose for public comment Rule 12d1-1 under the Investment Company Act of 1940. Rule 12d1-1 would provide an exemption from the limitations imposed by Section 12(d)(1)(A) of that Act for acquisitions of securities of foreign banks and foreign insurance companies by registered investment companies. For further information, please contact Ann M. Glickman at (202) 272-3042.

3. Consideration of whether to propose for public comment amendments to Rule 12d3-1 Under the Investment Company Act of 1940. The proposed amendments would facilitate the acquisition of the equity securities of a foreign securities firm by a registered investment company and any company or companies controlled by such company. For further information, please contact Christopher Sprague at (202) 272-7779.

4. Consideration of whether to repropose for public comment Rule 144A, which would provide a safe harbor exemption from the registration requirements of the Securities Act of 1933 for resale of restricted securities to "qualified institutional buyers" as defined in the Rule. The Commission also is reproposing amendments to Rules 144 and 145 under the Securities Act, which would redefine the required holding period for restricted securities, whether acquired pursuant to Rule 144A or otherwise. For further information, please contact Daniel W. Rumsey at (202) 272-3246.

5. Consideration of whether to propose for publish comment a revised proposed regulation that would clarify the extraterritorial application of the registration provisions of the Securities Act of 1933. For further information, please contact Sara Hanks at (202) 272-3246.

At times, changes in Commission priorities require alterations in the scheduling of meeting items. For further information and to ascertain what, if any, matters have been added, deleted or postponed, please contact: Amy Kroll at (202) 272-2200.

Jonathan G. Katz,

Secretary.

July 3, 1989.

[FR Doc. 89-16037 Filed 7-3-89; 8:45 am]

BILLING CODE 8010-01-M

Corrections

Federal Register
Vol. 54, No. 128
Thursday, July 6, 1989

This section of the FEDERAL REGISTER contains editorial corrections of previously published Presidential, Rule, Proposed Rule, and Notice documents. These corrections are prepared by the Office of the Federal Register. Agency prepared corrections are issued as signed documents and appear in the appropriate document categories elsewhere in the issue.

COMMITTEE FOR PURCHASE FROM THE BLIND AND OTHER SEVERELY HANDICAPPED

Procurement List 1989; Proposed Additions

Correction

In notice document 89-14941 appearing on page 26828 in the issue of Monday, June 26, 1989, make the following correction:

In the first column, the last line should read "2562 Avery Avenue."

BILLING CODE 1505-01-D

FEDERAL MARITIME COMMISSION

Agreement(s) Filed

Correction

In notice document 89-15143 appearing on page 27061 in the issue of Tuesday, June 27, 1989, make the following correction:

On page 27061, in the third column, in the line immediately following the second complete paragraph, the agreement number should read: "232-011230-001".

BILLING CODE 1505-01-D

DEPARTMENT OF THE INTERIOR

Bureau of Land Management

[CA-010-09-4212-13; CA 22479]

Realty Action; Termination of Proposed Exchange of Public Lands in Placer and Yuba Counties, CA

Correction

In notice document 89-2433 appearing on page 5283 in the issue of Thursday, February 2, 1989, make the following correction:

In the second column, under the first **Placer County, California**, in the seventh line, "Sec. 5," should read "Sec. 35,".

BILLING CODE 1505-01-D

NUCLEAR REGULATORY COMMISSION

10 CFR Part 7

Advisory Committees; Policies and Procedures

Correction

In rule document 89-15080 beginning on page 26947 in the issue of Tuesday, June 27, 1989, make the following corrections:

§ 7.10 [Corrected]

On page 26951, in the first column, in § 7.10(b)(1), "At" should read "A".

§ 7.11 [Corrected]

2. On the same page, in the second column, in § 7.11(b), in the fifth line, "expect" should read "except".

3. On the same page, in the second column, in § 7.11(d)(2), in the second line, "adjournment" was misspelled.

BILLING CODE 1505-01-D

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-26805; File Nos. SR-NYSE-88-29; SR-NYSE-88-8; SR-NASD-88-29; SR-NASD-88-51;SR-NASD-89-19; SR-AMEX-88-29]

Self-Regulatory Organizations; Order Approving Proposed Rule Changes by the New York Stock Exchange, Inc., National Association of Securities Dealers, Inc., and the American Stock Exchange, Inc. Relating to the Arbitration Process and the Use of Predispute Arbitration Clauses

Correction

In notice document 89-11723 beginning on page 21144 in the issue of Tuesday, May 16, 1989, make the following correction:

On page 21155, in the second column, in footnote 61, in the last line, "September 13, 1989" should read "September 7, 1989".

BILLING CODE 1505-01-D

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. 89-ANE-04; Amdt. 39-6221]

Airworthiness Directives; GQ Parachutes, Ltd., Type 350 Parachute Assemblies (P/N's MRI GQ 1277, MRI GQ 1304 and MRI GQ 1325), 850 Parachute Assemblies (P/N's MRI GQ 1284, MRI GQ 1315 and MRI GQ 1330), and 4.8m SAC Parachutes (P/N's MRI GQ 1308 and MRI GQ D22918/2)

Correction

In rule document 89-14235 beginning on page 25445 in the issue of Thursday, June 15, 1989, make the following correction:

§ 39.13 [Corrected]

On page 25446, in the first column, in the sixth complete paragraph, in the fourth line, the date should read "January 18, 1989".

BILLING CODE 1505-01-D

federal register

Thursday
July 6, 1989

Part II

Department of the Treasury

Internal Revenue Service

26 CFR Parts 1 and 602

Taxation of Fringe Benefits and Exclusions From Gross Income for Certain Fringe Benefits; Final and Temporary Regulations

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

[T.D. 8256]

RIN 1545-AH73

Taxation of Fringe Benefits and Exclusions From Gross Income for Certain Fringe Benefits

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations concerning the taxation and valuation of fringe benefits and exclusions from gross income for certain fringe benefits. This document also specifies the effective dates for certain temporary regulations relating to the same matters. Changes to the applicable law were made by the Tax Reform Act of 1984, the Consolidated Omnibus Budget Reconciliation Act of 1985, the Repeal of Contemporaneous Recordkeeping Requirements, and the Tax Reform Act of 1986. The regulations affect any person providing or receiving fringe benefits. The regulations provide these persons with the guidance necessary to comply with the law.

EFFECTIVE DATE: The final regulations are effective as of January 1, 1989, except that §§ 1.132–1(b)(1) with respect to the use of air transportation by a parent of an employee and 1.132–4(d) are effective as of January 1, 1985. The temporary regulations are effective from January 1, 1985, through December 31, 1988.

FOR FURTHER INFORMATION CONTACT: Richard Pavel at telephone 202–377–9372 (Not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this final regulation has been reviewed and approved by the Office of Management and Budget in accordance with the requirements of the Paperwork Reduction Act (44 U.S.C. 3504(h)) under control number 1545–0771. The estimated average burden per respondent/recordkeeper is 5 hours and 30 minutes.

These estimates are an approximation of the average time expected to be necessary for a collection of information. They are based on such information as is available to the Internal Revenue Service. Individual respondents/recordkeepers may require more or less time, depending on their particular circumstances.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be directed to the Internal Revenue Service, Attn: IRS Reports Clearance Officer TR:FP, Washington, DC 20224, and to the Office of Management and Budget, Paperwork Reduction Project, Washington, DC 20503.

Background

On December 23, 1985, the **Federal Register** published temporary regulations (50 FR 52281) on the taxation and valuation of fringe benefits and exclusions from gross income for certain fringe benefits. Those regulations provide guidance on the tax treatment of taxable and nontaxable fringe benefits and general rules for the valuation of taxable fringe benefits. The regulations also provide special rules for valuing employer-provided vehicles, flights on employer-provided aircraft, employer-provided free or discounted flights on commercial airlines, and meals at employer-operated eating facilities. The text of those temporary regulations also served as the comment document for a notice of proposed rulemaking ("the proposed regulations") published in the **Federal Register** for the same day (50 FR 52333).

Many comments were received from the public on the proposed regulations. In addition, on April 29, 1986, the Internal Revenue Service held a public hearing concerning the regulations. In response to the comments received and the statements made at the public hearing, the proposed regulations have been adopted as revised by this Treasury decision.

The final regulations contained in this document apply as of January 1, 1989. The final regulations under section 61 are contained in § 1.61–21. The final regulations under section 132 are contained in § 1.132–0 through § 1.132–8; § 1.132–0 contains an outline of the section 132 regulations. For benefits received in 1985, 1986, 1987 and 1988, the temporary regulations published in the **Federal Register** for December 23, 1985, apply. Those regulations are contained in § 1.61–2T and § 1.132–1T through § 1.132–8T.

Certain provisions of the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) and the Tax Reform Act of 1986 apply to benefits received after 1984. Even though these provisions are reflected in the final regulations and not in the temporary regulations, the provisions are effective as of January 1, 1985. For these rules, see the following discussion concerning no-additional-cost services.

Summary of Comments and Explanation of Provisions

Cost of Group-Term Life Insurance on the Life of an Individual Other Than an Employee

The final regulations clarify that the cost of group-term life insurance on the life of an individual other than an employee (such as the spouse of an employee), even if an incidental cost, is to be included in the employee's gross income.

Provider of a Fringe Benefit

The final regulations make clear that a fringe benefit provided to an employee by someone other than the employer (such as a client or customer of the employer) must be included in the employee's income, unless otherwise excluded.

Election To Use Special Valuation Rules

Many comments were received on the requirement that employers notify employees of their intent to use a special valuation rule. Commentators questioned the purpose of the notification requirement. Commentators also suggested that the regulations provide guidance on the manner of providing the notice to employees and the information that must be contained in the notice.

The purpose of the notification requirement is to advise employees of the substantiation requirements that apply when certain special valuation rules are used. For example, if an employer intends to use the automobile lease valuation rule or the vehicle cents-per-mile valuation rule, adequate records that substantiate the employee's business use of the vehicle must be maintained (see section 274(d) and the regulations thereunder). On the other hand, if the commuting valuation rule is used, the employee need only keep track of the number of one-way commutes in the vehicle. When the commuting valuation rule is used, the section 274(d) substantiation requirement is satisfied by the employer's written policy statement and records that indicate that the conditions of the commuting valuation rule are satisfied.

The final regulations provide that employers must notify employees of (1) the special valuation rule or rules that they intend to use, (2) the applicable substantiation requirements, and (3) the effect of failing to comply with the substantiation requirements. The final regulations also provide that the notice

must be provided in a manner reasonably expected to come to the attention of all affected employees. For example, the notice may be provided in a mailing or with the employees' paychecks.

The final regulations also provide that employers need not notify employees of their intention to continue using a particular valuation rule in a subsequent calendar year. Therefore, if an employer notified an employee that the automobile lease valuation rule would be used for 1989 the employer need not provide additional notification that the same rule will be used for 1990.

Commentators questioned the effect of an employer's failure to satisfy the notification requirement with respect to a particular employee. The final regulations provide that an employer may use a special valuation rule for a year even though the employer did not provide the requisite notice for that year only if the employer receives a statement from the affected employee indicating that the employee knows (1) that the employer intends to use a particular valuation rule for that year, (2) the applicable substantiation requirements, and (3) the effect of a failure to comply with such requirements. The employee statement must be received by January 31 of the year following the year for which the notice was not provided.

Automobile Lease Valuation Rule

Commentators requested that the final regulations provide guidance on determining the fair market value of automobiles that are leased by an employer. In response to the comments, the final regulations provide that employers who lease automobiles may treat the manufacturer's suggested retail price of an automobile less eight percent as the fair market value of the automobile for purposes of calculating the Annual Lease Value of a leased automobile.

It should also be noted that the determination of the fair market value of an automobile that is purchased by an employer has been revised in the final regulations, so that sales tax and title fees attributable to the purchase of an automobile are part of the purchase price of the automobile.

The proposed regulations provide that the value of an automobile available to an employee for less than 30 consecutive days is the Daily Lease Value. The Daily Lease Value is four hundred percent of a pro-rated Annual Lease Value. With respect to three situations, commentators complained that the Daily Lease Value is not the appropriate measure of value.

The first situation occurs when an automobile is provided to an employee for a continuous period of more than 30 days, but the period of availability straddles two calendar years. The final regulations permit use of a pro-rated Annual Lease Value in this case.

The second situation occurs with respect to the provision of demonstration automobiles to employees of automobile dealerships. Commentators stated that employees of automobile dealerships are provided automobiles on a continuous basis, but that because the automobiles are included in the dealership's inventory and thus are subject to sale, a particular automobile may not be available to an employee for at least 30 consecutive days. Because the employees have demonstration automobiles available on a continuous basis for periods in excess of 30 days, the Annual Lease Value or a pro-rated Annual Lease Value more appropriately reflects the value of the benefit provided to the employees. The final regulations permit this treatment and provide that such values are generally determined by reference to the average of the fair market values of the automobiles available to the employees.

The third situation involves fleet automobiles. Commentators stated that employees who have fleet automobiles continuously available for 30 or more days may not have the use of the same automobile for at least 30 consecutive days. The final regulations provide that if an employer is using the fleet-average valuation rule and makes fleet automobiles available to an employee for a period of at least 30 consecutive days, the employer may treat the employee as having one of the fleet automobiles available to him for the entire period. In this case, the automobile deemed available is treated as having a fair market value equal to the fleet-average value.

The proposed regulations provided that the value of fuel provided in kind may be valued at 5.5 cents per mile and that the cost of fuel reimbursements or charges to the employer must be determined by reference to the actual amount of reimbursement or charge. Many commentators objected stating that it is difficult to determine the amount reimbursed or charged when fuel is provided for many automobiles. They stated that the fuel valuation rule should be the same whether or not the fuel is provided in kind.

For administrative convenience, the final regulations provide that an employer using the fleet-average valuation rule may value fuel provided to employees (whether or not provided in kind) at 5.5 cents per mile if it would impose unreasonable administrative burdens on the employer to determine the actual amount reimbursed or charged.

Valuation of Chauffeur Services

Commentators also requested that the regulations provide guidance on the valuation of chauffeur services. The final regulations provide that the services of a chauffeur may be valued by reference to either: (1) The fair market value of such services as determined in an arm's length transaction; or (2) the compensation of the chauffeur. For this purpose, the chauffeur's compensation includes compensation as defined in section 414 (q) (7) as well as the fair market value of nontaxable lodging (if any) provided to the chauffeur by the employer. Under either method, the amount of time that a chauffeur is on-call to perform driving services for the employer is included in the value of such services. If a chauffeur drives an employee for both business and personal purposes, the value of the chauffeur's services that is includible in the employee's income is based on the amount of time the chauffeur spends driving or is on-call to drive the employee for personal purposes. The final regulations elaborate upon these rules and provide examples of the computations.

An employee may exclude from gross income, as a working condition fringe benefit, the excess of the value of the chauffeur services over the value of the chauffeur services for personal purposes as determined under § 1.61–21(b)(5).

Moreover, if an employer provides an employee with a bodyguard/chauffeur for a bona fide business-oriented security concern, and but for such bona fide business-oriented security concern, the employee would not have been provided such a bodyguard/chauffeur, the entire value of the services of the bodyguard/chauffeur is excludable from gross income as a working condition fringe. A bodyguard/chauffeur must be trained in evasive driving techniques.

Vehicle Cents-per-Mile Valuation Rule

Many commentators were pleased that the proposed regulations provided a vehicle cents-per-mile valuation rule. Commentators stated, however, that the rule is not available to value the personal use of vehicles valued at greater than the threshold amount (e.g., $12,800 for 1988). Because application of the cents-per-mile rule to the personal use of vehicles valued at greater than the threshold amount results in undervaluation of the benefit provided, the final regulations retain the

restriction contained in the proposed regulations.

The threshold amount is determined by reference to the total recovery deductions available with respect to a vehicle placed in service in the current year. The final regulations provide, that the threshold amount for vehicles placed in service before 1989 remains no more than $12,800. With respect to vehicles placed in service in or after 1989, the threshold amount is $12,800 as adjusted for the automobile price inflation adjustment.

Commentators requested that the regulations provide guidance on the requirement that the vehicle be regularly used in the employer's business. In response, the final regulations provide two safe harbor rules. A vehicle is considered regularly used in an employer's business if the vehicle is generally used each workday to transport at least three employees in an employer-sponsored commuting vehicle pool. A vehicle is also considered regularly used in an employer's business if at least 50 percent of the miles placed on the vehicle during the year are for the employer's business. The requirements for the use of the vehicle cents-per-mile rule are relaxed in the final regulations by deleting the requirement that the vehicle must be driven by each employee who wants to take advantage of the rule at the rate of 10,000 miles per year. Therefore, as long as the vehicle is driven 10,000 miles during a year and meets the other requirements of the vehicle cents-per-mile rule, each employee who makes use of that vehicle may take advantage of the vehicle cents-per-mile rule.

Co-Owner or Co-Lessee

To determine the fair market value of an automobile for purposes of applying the annual lease valuation rule or the dollar limitation required by the vehicle cents-per-mile rule, the final regulations provide special rules for calculating such amounts when a vehicle is owned or leased by both an employer and an employee.

Generally, if the employee receives an ownership interest in the vehicle, the fair market value of the vehicle for purposes of determining the Annual Lease Value, or for applying the vehicle cents-per-mile dollar limitation is computed by deducting the amount of the employee's contribution. If the interest acquired by the employee in the vehicle is not proportionate to the employee's contribution, the reduction in fair market value is decreased. Similar rules apply in the situation of an employee contribution to a lease. If the employee does not receive an ownership interest in the employer-provided vehicle, then the fair market value is determined without regard to any amount contributed by the employee. However, the amounts contributed by the employee will then reduce the amount includible in the employee's income for the personal use of the vehicle. An example illustrates the application of this rule.

Commuting Valuation Rule

In General

The commuting valuation rule is available to value the commuting-only use of employer-provided vehicles. The rule is not available if an employee is allowed to make more than de minimis use of the vehicle for any personal purpose other than commuting or if the employee in fact makes more than de minimis use of the vehicle for other personal purposes. The proposed regulations also provided that the rule is not available if the employee is a control employee. The final regulations retain the control employee restriction provided in the proposed regulations. The restriction was retained because there was concern that employees who are able to control the use or assignment of employer-provided vehicles might not impose these usage restrictions on themselves. There is also concern that control employees are provided the commuting use of more expensive vehicles than are provided to non-control employees.

The commuting valuation rule applies only if the employer requires the employee to use the vehicle in the employer's business and provides the vehicle to employees for a bona fide noncompensatory business reason of the employer. Commentators stated that the commuting valuation rule should be available when the vehicle is provided for use in an employer-sponsored commuting vehicle pool but does not meet these two requirements. The final regulations provide that a vehicle generally used each workday to transport at least three employees to and from work in an employer-sponsored commuting pool is deemed to meet the business use and business reason requirements.

Shared Vehicle Usage

Although the proposed regulations set forth a number of special valuation rules for the use of a vehicle, those regulations did not address the situation of shared vehicle usage by more than one employee at the same time. The final regulations provide that if an employer provides a vehicle to employees for use by more than one employee at the same time, the employer may use any of the special valuation rules that would otherwise be applicable to value the use of that vehicle. However, the employer must apply the same rule with respect to all such employees and must allocate the value of the use of the vehicle among the employees who share the use of the vehicle based upon the relevant facts and circumstances.

Control Employee Definition

The preamble to the proposed regulations requested comments from the public on the definition of a control employee of a government employer. Commentators requested that the Service and Treasury clarify the definition of an executive officer of a state or local government. In response, the final regulations replace both the executive officer test and the appointment and confirmation test of the proposed regulations with a single compensation test. Thus, under the final regulations, a control employee of a government employer is either an elected official or an employee whose compensation equals or exceeds the compensation paid to a Federal Government employee holding a position at Executive Level V, determined under chapter 11 of title 2, United States Code, as adjusted by section 5318 of title 5, United States Code.

Since the temporary regulations were issued, some commentators have expressed concern that the nongovernment control employee definition provided in the proposed regulations may inappropriately treat certain employees as control employees. For example, employees who are named officers of nongovernment employers but who do not have the authority to control the use or availability of employer-provided vehicles should not be treated as control employees. In response, the final regulations amend the definition of a control employee of a nongovernment employer to provide that an officer of an employer is a control employee only if the officer's compensation equals or exceeds $50,000, as indexed (for 1988 the compensation level rose to $52,235).

It is also apparent that many employees of nongovernment employers have the ability to control the use or availability of employer-provided vehicles but are not officers or owners of the employer. Because these employees should be treated as control employees but were not under the definition in the proposed regulations, the final regulations provide that an

employee whose compensation equals or exceeds $100,000 is a control employee, whether or not the employee is also an officer or owner of the employer.

To provide uniformity within the fringe benefits rules, the final regulations permit an employer to treat all employees who are "highly compensated" employees under the nondiscrimination rules of section 132 as control employees in lieu of applying the commuting rule control employee definition. Under this option, all employees who are "highly compensated" employees are considered "control employees" for purposes of the commuting valuation rule, and employees who are not "highly compensated" are not considered "control employees" regardless of their positions.

Noncommercial Aircraft Flight Valuation Rule

Flight on an Employer-Provided Aircraft

The proposed regulations provided a single general valuation rule to determine the fair market value of a personal flight on an employer-provided aircraft. The final regulations provide further guidance on the appropriate determination and distinguish between a piloted aircraft and an aircraft furnished without a pilot.

The value of a flight on a piloted employer-provided aircraft solely for personal purposes is equal to the amount that an individual would have to pay in an arm's-length transaction to charter the same or a comparable piloted aircraft for that period for the same or a comparable flight. The value of a flight on an employer-provided aircraft that is furnished without a pilot solely for personal purposes is the amount that an individual would have to pay in an arm's-length transaction to lease the same or comparable aircraft on the same or comparable terms for the same period in the geographic area in which the aircraft is used.

If the flight is for both business and personal purposes, then the portion attributable to personal purposes will be included in the employee's income. Moreover, a flight by any employee which is solely for business purposes may be excludable from income pursuant to section 132(d) and § 1.132–5.

Control Employee Definition

Under the proposed regulations, the safe harbor value of a flight on an employer-provided aircraft depends on whether the employee is a control employee. Those regulations define a control employee as any officer of the employer, limited to the lesser of one percent of all employees of the employer, or ten employees. If an employer is part of a controlled group of corporations or is otherwise required to be aggregated with other employers under certain aggregation rules, the proposed regulations provide that the officer test must be applied with respect to each separate employer, rather than with respect to the employer group.

Commentators objected stating that the officer test should be applied with respect to the employer group, rather than to each separate employer. Under this approach, an employee would be a control employee only if the employee were an officer of the controlled group of entities. Because employees are generally officers of separate entities of a controlled group of corporations, rather than officers of the group, the final regulations retain the rule of the proposed regulations. However, an officer of one entity of a controlled group of entities shall not be treated as an officer of any of the other entities of the controlled group.

A similar limitation rule is provided with respect to the highly-paid control employee test. The final regulations define a control employee as an employee within the top one-percent most highly-paid employees, limited to a maximum of 50 employees.

The final regulations also provide guidance as to the circumstances under which a control employee who is no longer employed by the employer will continue to be treated as a control employee. The former employee rule does not affect the number of employees who may be treated as control employees under the officer and compensation limits of the control employee definition used for the aircraft valuation rule.

Seating Capacity Rule

The proposed regulations provided a special seating capacity rule under which the value of a flight on an employer-provided aircraft may in some situations be deemed to be zero. The special rule is based on the regular passenger seating capacity of the aircraft.

Commentators requested that the regulations provide additional guidance on determining the regular passenger seating capacity of an aircraft. In response, the final regulations provide that the regular passenger seating capacity of an aircraft does not include seats that cannot legally be used during takeoff and have not at any time been used during takeoff. Jumpseats and removable seats used solely for purposes of flight crew training are included in the regular passenger seating capacity if the seats can legally be used or have ever been used during takeoff for other than flight crew training. The final regulations also provide that the regular passenger seating capacity of an aircraft reflects any permanent reduction in the number of seats on the aircraft. However, if at any time within 24 months after such reduction, any seats are added back to the aircraft, the total passenger seating capacity prior to the reduction will be counted for purposes of this rule.

Under the seating capacity rule of the proposed regulations, if at least 50 percent of the regular passenger seating capacity of an aircraft is occupied by individuals whose flights are primarily for the employer's business, the value of a flight on the aircraft by an employee, his spouse, or dependent child is deemed to be zero. When determining whether the seating capacity rule is satisfied, the proposed regulations provide that the 50-percent test must be satisfied when the individual whose flight is being valued boards the aircraft and when the individual deplanes.

Commentators stated that the 50-percent test should be applied either at the time the individual boards the aircraft or at the time the individual deplanes. Other commentators stated the seating capacity rule should be replaced by a rule providing that the value of a flight is zero if at least 50 percent of the passengers on board were flying for the employer's business.

The seating capacity rule provided in the proposed regulations reflects the provisions of a Treasury Department letter addressed to Senator Robert Dole (131 Cong. Rec. S6369 (daily ed. May 16, 1985)). For the reasons cited in the letter, the final regulations retain the seating capacity rule as proposed.

Commercial Aircraft Flight Valuation Rule—Space Available Flight

For purposes of the definition of a space available flight in the commercial flight valuation rule, the final regulations clarify that a flight will not be considered a space available flight unless the nondiscrimination requirements of § 1.132–8 of the regulations is satisfied.

No-Additional-Cost Services

Prior to the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA), a no-additional-cost service (such as a space-available flight on a commercial airline) was excludable from gross income if provided to an employee of the airline, the employee's spouse, or the employee's dependent

child. The proposed regulations reflect this provision. COBRA amended this rule, however, to provide that the no-additional-cost service exclusion is also available in the case of air transportation provided to the parents of an airline employee. The final regulations reflect the COBRA change which is effective for flights taken after December 31, 1984.

COBRA also provided rules concerning the applicability of the no-additional-cost service exclusion to space-available flights provided to employees working in airline-related services and employees working for qualified air transportation organizations. In addition, the Tax Reform Act of 1986 provided rules concerning the applicability of the no-additional-cost service exclusion to telephone service provided to pre-divestiture employees. The final requlations reflect these rules which are effective January 1, 1985.

Line of Business

A no-additional-cost service or a qualified employee discount provided to an employee (or a no-additional-cost service provided pursuant to a reciprocal agreement) is only available with respect to property or services that are offered for sale to customers in the ordinary course of the same line of business in which the employee receiving the property or service performs substantial services.

The final regulations clarify that the line of business limitation is not satisfied if the employer's products or services are sold primarily to employees of the employer, rather than to customers. Moreover, the final regulations clarify that the line of business requirement is a limitation upon, and may not be used as a means to expand, the fringe benefits that may be offered to employees.

Finally, the regulations provide for certain grandfather rules relating to certain retail stores, telephone services provided to pre-divestiture retirees, certain affiliates of commercial airlines, affiliated groups operating airlines, and qualified air transportation organizations.

Employer-Operated Eating Facility Rules

Section 132(e) provides that gross income does not include the value of meals provided at an employer-operated eating facility if revenues from the facility normally equal or exceed the direct operating costs of the facility and certain nondiscrimination rules are satisfied. The proposed regulations defined direct operating costs and provided that the direct operating costs test must be applied to each separate facility operated by an employer. A special exclusion for the costs and revenues attributable to meals received by volunteers at a hospital, either free or at a discount, has been added in the final regulations.

Many commentators stated that administrative burdens would be relieved if employers were allowed to aggregate the costs and revenues of their eating facilities to determine whether the direct operating costs test is met. The final regulations adopt this approach. It should be noted, however, that the final regulations do not permit employers to aggregate eating facilities for purposes of the nondiscrimination rules.

The proposed regulations defined an employer-operated eating facility for employees. One of the conditions provided in those regulations is that substantially all of the use of the facility is by employees of the employer. As requested by commentators, the final regulations remove the restriction.

Where the value of meals in an employer-operated eating facility may not be excluded from income under these regulations, that value must be included in the employee's income. The final regulations provide that the amounts to be included in the employee's income must be calculated separately with respect to each separate eating facility, even if the facilities were aggregated for other purposes.

The final regulations clarify that the individual meal subsidy rule is only available if a charge is made to each employee for each meal selection and if each employee is charged the same price for any given meal selection.

Finally, for purposes of applying the total meal subsidy rule, the final regulations provide that an employer may only allocate the total meal subsidy on a per-employee basis if such employer has information that would substantiate that each employee was provided approximately the same number of meals at the facility.

Working Condition Fringes—In General

The final regulations provide additional examples to illustrate many of the working condition fringe benefit rules.

The final regulations further provide that in lieu of excluding the value of a working condition fringe with respect to an automobile, an employer using the automobile lease valuation rule may include in an employee's gross income the entire Annual Lease Value of the automobile.

Security Transportation

The value of transportation provided for security reasons may be excludable from gross income as a working condition fringe to the extent a deduction under section 162 or 167 would be allowable to the employee had the employee paid for the same mode of transportation.

The proposed regulations provided guidance on when bona fide business-oriented security concerns exist both in and outside the United States. Commentators stated that the regulations should not distinguish between security provided in and outside the United States. In addition, commentators stated that the final regulations should provide that the security concerns listed in the proposed regulations are merely examples of when bona fide business-oriented security concerns exist and are not the only ways to demonstrate such concerns. Commentators also suggested that the final regulations provide additional examples of when security concerns exist.

In response to comments, the final regulations eliminate the domestic/foreign distinction and provide the following examples of factors indicating the existence of bona fide business-oriented security concerns—death threats, threats of kidnapping or serious bodily harm, and a history of violent terrorist activity in the relevant geographic area.

If transportation is provided for security reasons to the spouse or dependents of an employee, the proposed regulations provide that the security rules must be satisfied independently with respect to those individuals. Commentators stated that the security rules should be treated as satisfied with respect to the spouse and dependents of an employee if they are satisfied with respect to the employee.

The final regulations provide that if a bona fide business-oriented security concern is deemed to exist with respect to an employee, such concern is deemed to exist with respect to the spouse and dependents of the employee as well. If the requirements for a security program are then satisfied with respect to the spouse and dependents, the excess value attributable to security provided for their protection is excludable from the employee's gross income.

The final regulations provide that when an employee's spouse and dependents fly on board the same aircraft as the employee for a bona fide business-oriented security concern, the requirements for a security program are

deemed to be satisfied with respect to the spouse and dependents for that flight. In all other situations, the security program requirements must be satisfied independently with respect to the spouse and dependents of an employee.

Moreover, the regulations clarify that for purposes of the working condition safe harbor for travel on an employer-provided aircraft because of a bona fide business-oriented security concern, the value of the safe harbor airfare is determined under the non-commercial flight special valuation rule by requiring the employee to include in income 200 percent of the applicable cents-per-mile rate and then adding the applicable terminal charge.

Commentators requested that the final regulations clarify the tax treatment to the employee of a bodyguard/chauffeur provided to such employee for security reasons. The final regulations provide that if the security rules are satisfied, the entire value of the services of a bodyguard/chauffeur are excludable from the gross income of the protected employee as a working condition fringe. The final regulations require that a bodyguard/chauffeur be trained in evasive driving techniques.

Product Testing

Based on the legislative history of the Tax Reform Act of 1984, the proposed regulations provided that the value of the use of consumer goods provided to employees under a product testing program may be excluded from gross income as a working condition fringe.

Commentators also requested that the final regulations provide that certain conditions of the product testing exclusion are not violated if the employer charges the employee for the personal use of the product, such as an automobile. In response to this suggestion, the final regulations provide that any charge by the employer for the personal use by an employee of a product being tested shall be taken into account in determining whether the employer has imposed limits on the employee's use of the product that significantly reduce the value of the personal benefit to the employee.

Qualified Automobile Demonstration Use

Section 132(h)(3) provides an exclusion for the value of the qualified automobile demonstration use of demonstration automobiles by full-time automobile salesmen. The proposed regulations defined a full-time automobile salesman as an individual who is employed by the dealership, customarily spends substantially all of a normal business day on the sales floor selling automobiles of the dealership, and derives at least 85 percent of his gross income from the dealership directly as a result of his sales activities.

Commentators stated that full-time automobile salesmen do not necessarily spend most of the business day on the sales floor, but that they engage in sales activities off the dealership premises. In response, the final regulations amend the definition of a full-time salesman to provide that the employee must customarily spend at least half of a normal business day performing the functions of a floor salesperson or sales manager and must directly engage in substantial promotion and negotiation of sales to customers.

In response to comments, the final regulations also reduce the 85-percent income test to a 25-percent income test.

Shared Usage of Qualified Nonpersonal Use Vehicle

The proposed regulations provided that 100% of the value of the use of a qualified nonpersonal use vehicle is excluded from the gross income of the employee. The final regulations provide that, in general, a working condition fringe is available to the driver and all passengers of a qualified nonpersonal use vehicle. However, a working condition fringe exclusion for a qualified nonpersonal use vehicle is available only with respect to the driver and not with respect to any of the passengers of a passenger bus or school bus.

Parking

The final regulations provide that if an employer provides an employee with a general transportation allowance, and the employee is not required to use such allowance for parking, no portion of such amount is excludable as a parking expense even if those funds are actually used for parking.

De minimis Fringes

The proposed regulations provided a special de minimis fringe exclusion for the value of public transit passes that do not exceed $15 per month provided to employees to defray commuting expenses. Commentators stated that this exclusion should also apply if the employer provides vouchers or similar instruments exchangeable solely for tokens, farecards, or other instruments that enable the employee to use the transit system. The final regulations adopt this suggestion (subject to the $15 per month limit).

The proposed regulations also provided a special de minimis exclusion for occasional meal money or local transportation fare provided to employees whose normal workday is extended because of overtime work. Commentators requested a definition of the term "occasional." In response, the final regulations provide guidance on this issue.

The final regulations also provide special rules for local transportation fare provided in unusual circumstances and for security reasons. These rules permit an exclusion from gross income for the fare that exceeds $1.50 per one-way commute. The final regulations define when unusual circumstances and security concerns exist.

Nondiscrimination Rules

The proposed regulations provided guidance concerning the nondiscrimination requirements applicable to no-additional-cost services, qualified employee discounts, and employer-operated eating facilities for employees. Under these rules, the value of benefits provided to officers, owners, or highly compensated employees could not be excluded from their gross incomes unless the benefits were available on substantially the same terms to either (1) all of the employees of the employer or (2) each member of a group of employees that is defined under a reasonable classification that does not discriminate in favor of such employees. The Tax Reform Act of 1986 changes the prohibited group of employees to "highly compensated employees" defined as any employee who (1) is a five percent or greater owner, (2) received compensation in excess of $75,000, (3) received compensation in excess of $50,000 and who was in the top-paid 20 percent of employees, or (4) was an officer of the employer at any time and received compensation greater than 150 percent of the section 415(c)(1)(A) limit for this year. The final regulations reflect this change.

The employees who may be excluded from consideration have been changed in the final regulations. The proposed regulations included unionized employees unless all such employees were excluded. The final regulations exclude those employees who may be excluded from consideration under section 89(h).

A special nondiscrimination rule applies for benefits allocated on a seniority basis. In such circumstances, a benefit shall not fail to be treated as available to a group of employees on substantially the same terms if (1) notice of the terms of availability is provided to all employees in the group; and (2) the average value of the benefit provided per non-highly compensated employee is at least 75% of that provided per highly

compensated employee. In determining the average value of benefit provided, all employee's of the employer are counted, including those who receive no benefit from the employer.

Definition of Compensation

Generally, for purposes of the final regulations, a uniform definition of compensation has been added. Compensation is generally defined as the amount determined under section 414(q)(7). A chauffeur's compensation is defined as the sum of the amount determined under section 414(q)(7) plus the value of nontaxable lodging.

Consumer Price Index Adjustments

The final regulations generally provide that the limitations on the applicable values of vehicles for purposes of the special valuation rules (e.g., the $16,500 limitation on vehicles for use of the fleet average valuation rule) are to be adjusted annually for changes in the consumer price index automobile component. Similar adjustments to reflect changes in the consumer price index are to be made to the compensation limitations provided in the definition of control employee.

Prizes and Awards

These regulations do not address issues concerning prizes and awards. Separate guidance will be provided with respect to those issues.

Frequent Flyer

These regulations do not address issues concerning the tax treatment of frequent flyer bonus programs, and similar programs because these issues are still under consideration.

Executive Order 12291, Regulatory Flexibility Act, and Paperwork Reduction Act

The Commissioner of Internal Revenue has determined that this final rule is not a major rule as defined in Executive Order 12291 and that a regulatory impact analysis is therefore not required.

Although a notice of proposed rulemaking that solicited public comment was issued, the Internal Revenue Service concluded when the notice of proposed rulemaking was issued that the regulations are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 did not apply. Accordingly, the final regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. Chapter 6).

Drafting Information

The principal author of these final regulations is Rhonda G. Migdail of the Office of the Assistant Chief Counsel (Employee Benefits and Exempt Organizations), Internal Revenue Service. Personnel from other offices of the Internal Revenue Service and Treasury Department also participated in developing the regulations on matters of both substance and style.

List of Subjects

26 CFR 1.61–1—1.281–4

Income taxes, Taxable income, Deductions, Exemptions.

26 CFR 1.861–1—1.997–1

Income taxes, Aliens, Exports, DISC, Foreign investments in U.S., Foreign tax credit, Sources of income, United States investments abroad.

26 CFR Part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR Parts 1 and 602 are amended as follows:

PART 1—[AMENDED]

Paragraph 1. The authority for Part 1 is amended by adding the following citation:

Authority: 26 U.S.C. 7805 * * * Sections 1.61–21, 1.132–0, 1.132–1, 1.132–2, 1.132–3, 1.132–4, 1.132–5, 1.132–6, 1.132–7, and 1.132–8 also issued under 26 U.S.C. 132.

Par. 2. Section 1.61–2T is amended by revising the title of such section to read as follows:

§ 1.61–2T Taxation of fringe benefits—1985 through 1988 (Temporary).

Par. 3. Section 1.61–2T is amended by revising paragraphs (a)(6) and (e)(1)(iii) to read as follows:

(a) *Fringe benefits.* * * *

(6) *Effective date.* This section is effective from January 1, 1985, to December 31, 1988, with respect to fringe benefits furnished before January 1, 1989. No inference may be drawn from the promulgation or terms of this section concerning the application of law in effect prior to January 1, 1985.

(e) * * *

(1) * * *

* * * * *

(iii) *Limitation on use of the vehicle cents-per-mile valuation rule.* The value of the use of an automobile (as defined in paragraph (d)(1)(ii) of this section) may not be determined under the vehicle cents-per-mile valuation rule of this paragraph (e) if the fair market value of the automobile (determined pursuant to paragraphs (d)(5) (i) through (iv) of this section as of the later of January 1, 1985, or the first date on which the automobile is made available to any employee of the employer for personal use) exceeds $12,800. No inference may be drawn from the promulgation or terms of this section concerning the application of law in effect prior to January 1, 1985.

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§ 1.61–2 [Amended]

Par. 4. Section 1.61–2 is amended by revising paragraph (d)(2)(ii)(b) to read as follows:

(*b*) *Cost of group-term life insurance on the life of an individual other than an employee.* The cost (determined under paragraph (d)(2) of § 1.79–3) of group-term life insurance on the life of an individual other than an employee (such as the spouse or dependent of the employee) provided in connection with the performance of services by the employee is includible in the gross income of the employee.

Par. 5. Section 1.61–21 is added immediately following § 1.61–15 and reads as follows:

§ 1.61–21 Taxation of fringe benefits.

(a) *Fringe benefits*—(1) *In general.* Section 61(a)(1) provides that, except as otherwise provided in subtitle A of the Internal Revenue Code of 1986, gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items. For an outline of the regulations under this section relating to fringe benefits, see paragraph (a)(7) of this section. Examples of fringe benefits include: an employer-provided automobile, a flight on an employer-provided aircraft, an employer-provided free or discounted commercial airline flight, an employer-provided vacation, an employer-provided discount on property or services, an employer-provided membership in a country club or other social club, and an employer-provided ticket to an entertainment or sporting event.

(2) *Fringe benefits excluded from income.* To the extent that a particular fringe benefit is specifically excluded from gross income pursuant to another section of subtitle A of the Internal Revenue Code of 1986, that section shall govern the treatment of that fringe benefit. Thus, if the requirements of the governing section are satisfied, the fringe benefits may be excludable from gross income. Examples of excludable fringe benefits include qualified tuition

reductions provided to an employee (section 117(d)); meals or lodging furnished to an employee for the convenience of the employer (section 119); benefits provided under a dependent care assistance program (section 129); and no-additional-cost services, qualified employee discounts, working condition fringes, and de minimis fringes (section 132). Similarly, the value of the use by an employee of an employer-provided vehicle or a flight provided to an employee on an employer-provided aircraft may be excludable from income under section 105 (because, for example, the transportation is provided for medical reasons) if and to the extent that the requirements of that section are satisfied. Section 134 excludes from gross income "qualified military benefits." An example of a benefit that is not a qualified military benefit is the personal use of an employer-provided vehicle. The fact that another section of subtitle A of the Internal Revenue Code addresses the taxation of a particular fringe benefit will not preclude section 61 and the regulations thereunder from applying, to the extent that they are not inconsistent with such other section. For example, many fringe benefits specifically addressed in other sections of subtitle A of the Internal Revenue Code are excluded from gross income only to the extent that they do not exceed specific dollar or percentage limits, or only if certain other requirements are met. If the limits are exceeded or the requirements are not met, some or all of the fringe benefit may be includible in gross income pursuant to section 61. See paragraph (b)(3) of this section.

(3) *Compensation for services.* A fringe benefit provided in connection with the performance of services shall be considered to have been provided as compensation for such services. Refraining from the performance of services (such as pursuant to a covenant not to compete) is deemed to be the performance of services for purposes of this section.

(4) *Person to whom fringe benefit is taxable*—(i) *In general.* A taxable fringe benefit is included in the income of the person performing the services in connection with which the fringe benefit is furnished. Thus, a fringe benefit may be taxable to a person even though that person did not actually receive the fringe benefit. If a fringe benefit is furnished to someone other than the service provider such benefit is considered in this section as furnished to the service provider, and use by the other person is considered use by the service provider. For example, the provision of an automobile by an employer to an employee's spouse in connection with the performance of services by the employee is taxable to the employee. The automobile is considered available to the employee and use by the employee's spouse is considered use by the employee.

(ii) *All persons to whom benefits are taxable referred to as employees.* The person to whom a fringe benefit is taxable need not be an employee of the provider of the fringe benefit, but may be, for example, a partner, director, or an independent contractor. For convenience, the term "employee" includes any person performing services in connection with which a fringe benefit is furnished, unless otherwise specifically provided in this section.

(5) *Provider of a fringe benefit referred to as an employer.* The "provider" of a fringe benefit is that person for whom the services are performed, regardless of whether that person actually provides the fringe benefit to the recipient. The provider of a fringe benefit need not be the employer of the recipient of the fringe benefit, but may be, for example, a client or customer of the employer or of an independent contractor. For convenience, the term "employer" includes any provider of a fringe benefit in connection with payment for the performance of services, unless otherwise specifically provided in this section.

(6) *Effective date.* Except as otherwise provided, this section is effective as of January 1, 1989 with respect to fringe benefits provided after December 31, 1988. See § 1.61–2T for rules in effect from January 1, 1985, to December 31, 1988.

(7) *Outline of this section.* The following is an outline of the regulations in this section relating to fringe benefits:

§ 1.61–21 (a) *Fringe benefits.*
- (1) In general.
- (2) Fringe benefits excluded from income.
- (3) Compensation for services.
- (4) Person to whom fringe benefit is taxable.
- (5) Provider of a fringe benefit referred to as an employer.
- (6) Effective date.
- (7) Outline of this section.

§ 1.61–21 (b) *Valuation of fringe benefits*
- (1) In general.
- (2) Fair market value.
- (3) Exclusion from income based on cost.
- (4) Fair market value of the availability of an employer-provided vehicle.
- (5) Fair market value of chauffeur services.
- (6) Fair market value of a flight on an employer-provided piloted aircraft.
- (7) Fair market value of the use of an employer-provided aircraft for which the employer does not furnish a pilot.

§ 1.61–21 (c) *Special valuation rules.*
- (1) In general.
- (2) Use of the special valuation rules.
- (3) Election to use the special valuation rules.
- (4) Application of section 414 to employers.
- (5) Valuation formulae contained in the special valuation rules.
- (6) Modification of the special valuation rules.
- (7) Special accounting rule.

§ 1.61–21 (d) *Automobile lease valuation rule.*
- (1) In general.
- (2) Calculation of Annual Lease Value.
- (3) Services included in, or excluded from, the Annual Lease Value Table.
- (4) Availability of an automobile for less than an entire calendar year.
- (5) Fair market value.
- (6) Special rules for continuous availability of certain automobiles.
- (7) Consistency rules.

§ 1.61–21 (e) *Vehicle cents-per-mile valuation rule.*
- (1) In general.
- (2) Definition of vehicle.
- (3) Services included in, or excluded from, the cents-per-mile rate.
- (4) Valuation of personal use only.
- (5) Consistency rules.

§ 1.61–21 (f) *Commuting valuation rule.*
- (1) In general.
- (2) Special rules.
- (3) Commuting value.
- (4) Definition of vehicle.
- (5) Control employee defined—Non-government employer.
- (6) Control employee defined—Government employer.
- (7) "Compensation" defined.

§ 1.61–21 (g) *Non-commercial flight valuation rule.*
- (1) In general.
- (2) Eligible flights and eligible aircraft.
- (3) Definition of a flight.
- (4) Personal and non-personal flights.
- (5) Aircraft valuation formula.
- (6) Discretion to provide new formula.
- (7) Aircraft multiples.
- (8) Control employee defined—Non-government employer.
- (9) Control employee defined—Government employer.
- (10) "Compensation" defined.
- (11) Treatment of former employees.
- (12) Seating capacity rule.
- (13) Erroneous use of the non-commercial flight valuation rule.
- (14) Consistency rules.

§ 1.61–21 (h) *Commercial flight valuation rule.*
- (1) In general.
- (2) Space-available flight.
- (3) Commercial aircraft.
- (4) Timing of inclusion.
- (5) Consistency rules.

§ 1.61–21 (i) *[Reserved]*

§ 1.61–21 (j) *Valuation of meals provided at an employer-operated eating facility for employees.*
- (1) In general.
- (2) Valuation formula.

(b) *Valuation of fringe benefits*—(1) *In general.* An employee must include in gross income the amount by which the fair market value of the fringe benefit exceeds the sum of—

(i) The amount, if any, paid for the benefit by or on behalf of the recipient, and

(ii) The amount, if any, specifically excluded from gross income by some other section of subtitle A of the Internal Revenue Code of 1986.

Therefore, for example, if the employee pays fair market value for what is received, no amount is includible in the gross income of the employee. In general, the determination of the fair market value of a fringe benefit must be made before subtracting out the amount, if any, paid for the benefit and the amount, if any, specifically excluded from gross income by another section of subtitle A. See paragraphs (d)(2)(ii) and (e)(1)(iii) of this section.

(2) *Fair market value.* In general, fair market value is determined on the basis of all the facts and circumstances. Specifically, the fair market value of a fringe benefit is the amount that an individual would have to pay for the particular fringe benefit in an arm's-length transaction. Thus, for example, the effect of any special relationship that may exist between the employer and the employee must be disregarded. Similarly, an employee's subjective perception of the value of a fringe benefit is not relevant to the determination of the fringe benefit's fair market value nor is the cost incurred by the employer determinative of its fair market value. For special rules relating to the valuation of certain fringe benefits, see paragraph (c) of this section.

(3) *Exclusion from income based on cost.* If a statutory exclusion phrased in terms of cost applies to the provision of a fringe benefit, section 61 does not require the inclusion in the recipient's gross income of the difference between the fair market value and the excludable cost of that fringe benefit. For example, section 129 provides an exclusion from an employee's gross income for amounts contributed by an employer to a dependent care assistance program for employees. Even if the fair market value of the dependent care assistance exceeds the employer's cost, the excess is not subject to inclusion under section 61 and this section. However, if the statutory cost exclusion is a limited amount, the fair market value of the fringe benefit attributable to any excess cost is subject to inclusion. This would be the case, for example, where an employer pays or incurs a cost of more than $5,000 to provide dependent care assistance to an employee.

(4) *Fair market value of the availability of an employer-provided vehicle*—(i) *In general.* If the vehicle special valuation rules of paragraph (d), (e), or (f) of this section do not apply with respect to an employer-provided vehicle, the value of the availability of that vehicle is determined under the general valuation principles set forth in this section. In general, that value equals the amount that an individual would have to pay in an arm's-length transaction to lease the same or comparable vehicle on the same or comparable conditions in the geographic area in which the vehicle is available for use. An example of a comparable condition is the amount of time that the vehicle is available to the employee for use, e.g., a one-year period. Unless the employee can substantiate that the same or comparable vehicle could have been leased on a cents-per-mile basis, the value of the availability of the vehicle cannot be computed by applying a cents-per-mile rate to the number of miles the vehicle is driven.

(ii) *Certain equipment excluded.* The fair market value of a vehicle does not include the fair market value of any specialized equipment not susceptible to personal use or any telephone that is added to or carried in the vehicle, provided that the presence of that equipment or telephone is necessitated by, and attributable to, the business needs of the employer. However, the value of specialized equipment must be included, if the employee to whom the vehicle is available uses the specialized equipment in a trade or business of the employee other than the employee's trade or business of being an employee of the employer.

(5) *Fair market value of chauffeur services*—(i) *Determination of value*—(A) *In general.* The fair market value of chauffeur services provided to the employee by the employer is the amount that an individual would have to pay in an arm's-length transaction to obtain the same or comparable chauffeur services in the geographic area for the period in which the services are provided. In determining the applicable fair market value, the amount of time, if any, the chauffeur remains on-call to perform chauffeur services must be included. For example, assume that A, an employee of corporation M, needs a chauffeur to be on-call to provide services to A during a twenty-four hour period. If during that twenty-four hour period, the chauffeur actually drives A for only six hours, the fair market value of the chauffeur services would have to be the value of having a chauffeur on-call for a twenty-four hour period. The cost of taxi fare or limousine service for the six hours the chauffeur actually drove A would not be an accurate measure of the fair market value of chauffeur services provided to A. Moreover, all other aspects of the chauffeur's services (including any special qualifications of the chauffeur (e.g., training in evasive driving skills) or the ability of the employee to choose the particular chauffeur) must be taken into consideration.

(B) *Alternative valuation with reference to compensation paid.* Alternatively, the fair market value of the chauffeur services may be determined by reference to the compensation (as defined in paragraph (b)(5)(ii) of this section) received by the chauffeur from the employer.

(C) *Separate valuation for chauffeur services.* The value of chauffeur services is determined separately from the value of the availability of an employer-provided vehicle.

(ii) *Definition of compensation*—(A) *In general.* For purposes of this paragraph (b)(5)(ii), the term "compensation" means compensation as defined in section 414(q)(7) and the fair market value of nontaxable lodging (if any) provided by the employer to the chauffeur in the current year.

(B) *Adjustments to compensation*—For purposes of this paragraph (b)(5)(ii), a chauffeur's compensation is reduced proportionately to reflect the amount of time during which the chauffeur performs substantial services for the employer other than as a chauffeur and is not on-call as a chauffeur. For example, assume a chauffeur is paid $25,000 a year for working a ten-hour day, five days a week and also receives $5,000 in nontaxable lodging. Further assume that during four hours of each day, the chauffeur is not on-call to perform services as a chauffeur because that individual is performing secretarial functions for the employer. Then, for purposes of determining the fair market value of this chauffeur's services, the employer may reduce the chauffeur's compensation by $\frac{4}{10}$ or $12,000 (.4× ($25,000+$5,000)=$12,000). Therefore, in this example, the fair market value of the chauffeur's services is $18,000 ($30,000 −$12,000). However, for purposes of this paragraph (b)(5)(ii), a chauffeur's compensation is not to be reduced by any amounts paid to the chauffeur for time spent "on-call," even though the chauffeur actually performs other services for the employer during such time. For purposes of this paragraph (b)(5)(ii), a determination tnat a chauffeur is performing substantial services for the employer other than as a

chauffeur is based upon the facts and circumstances of each situation. An employee will be deemed to be performing substantial services for the employer other than as a chauffeur if a certain portion of each working day is regularly spent performing other services for the employer.

(iii) *Calculation of chauffeur services for personal purposes of the employee.* The fair market value of chauffeur services provided to the employee for personal purposes may be determined by multiplying the fair market value of chauffeur services, as determined pursuant to paragraph (b)(5)(i) (A) or (B) of this section, by a fraction, the numerator of which is equal to the sum of the hours spent by the chauffeur actually providing personal driving services to the employee and the hours spent by the chauffeur in "personal on-call time," and the denominator of which is equal to all hours the chauffeur spends in driving services of any kind paid for by the employer, including all hours that are "on-call."

(iv) *Definition of on-call time.* For purposes of this paragraph, the term "on-call time" means the total amount of time that the chauffeur is not engaged in the actual performance of driving services, but during which time the chauffeur is available to perform such services. With respect to a round-trip, time spent by a chauffeur waiting for an employee to make a return trip is generally not treated as on-call time; rather such time is treated as part of the round-trip.

(v) *Definition of personal on-call time.* For purposes of this paragraph, the term "personal on-call time" means the amount of time outside the employee's normal working hours for the employer when the chauffeur is available to the employee to perform driving services.

(vi) *Presumptions.* (A) An employee's normal working hours will be presumed to consist of a ten hour period during which the employee usually conducts business activities for that employer.

(B) It will be presumed that if the chauffeur is on-call to provide driving services to an employee during the employee's normal working hours, then that on-call time will be performed for business purposes.

(C) Similarly, if the chauffeur is on-call to perform driving services to an employee after normal working hours, then that on-call time will be presumed to be "personal on-call time."

(D) The presumptions set out in paragraph (b)(5)(vi) (A), (B), and (C) of this section may be rebutted. For example, an employee may demonstrate by adequate substantiation that his or her normal working hours consist of more than ten hours. Furthermore, if the employee keeps adequate records and is able to substantiate that some portion of the driving services performed by the chauffeur after normal working hours is attributable to business purposes, then personal on-call time may be reduced by an amount equal to such personal on-call time multiplied by a fraction, the numerator of which is equal to the time spent by the chauffeur after normal working hours driving the employee for business purposes, and the denominator of which is equal to the total time spent by the chauffeur driving the employee after normal working hours for all purposes.

(vii) *Examples.* The rules of this paragraph (b)(5) may be illustrated by the following examples:

Example (1). An employer makes available to employee A an automobile and a full-time chauffeur B (who performs no other services for A's employer) for an entire calendar year. Assume that the automobile lease valuation rule of paragraph (d) of this section is used and that the Annual Lease Value of the automobile is $9,250. Assume further that B's compensation for the year is $12,000 (as defined in section 414(q)(7)) and that B is furnished lodging with a value of $3,000 that is excludable from B's gross income. The maximum amount subject to inclusion in A's gross income for use of the automobile and chauffeur is therefore $24,250 ($12,000+$3,000+$9,250). If 70 percent of the miles placed on the automobile during the year are for A's employer's business, then $6,475 is excludable from A's gross income with respect to the automobile as a working condition fringe ($9,250×.70). Thus, $2,775 is includible in A's gross income with respect to the automobile ($9,250−$6,475). With respect to the chauffeur, if 20 percent of the chauffeur's time is spent actually driving A or being on-call to drive A for personal purposes; then $3,000 is includible in A's income (.20×$15,000). Eighty percent of $15,000, or $12,000, is excluded from A's income as a working condition fringe.

Example (2). Assume the same facts as in example (1) except that in addition to providing chauffeur services, B is responsible for performing substantial non-chauffeur-related duties (such as clerical or secretarial functions) during which time B is not "on-call" as a chauffeur. If B spends only 75 percent of the time performing chauffeur services, then the maximum amount subject to inclusion in A's gross income for use of the automobile and chauffeur is $20,500 (($15,000×.75)+$9,250). If B is actually driving A for personal purposes or is on-call to drive A for personal purposes for 20 percent of the time during which B is available to provide chauffeur services, then $2,250 is includible in A's gross income (.20×$11,250). The income inclusion with respect to the automobile is the same as in example (1).

Example (3). Assume the same facts as in example (2) except that while B is performing non-chauffeur-related duties, B is on call as A's chauffeur. No part of B's compensation is excluded when determining the value of the benefit provided to A. Thus, as in example (1), $3,000 is includible in A's gross income with respect to the chauffeur.

(6) *Fair market value of a flight on an employer-provided piloted aircraft*—(i) *In general.* If the non-commercial flight special valuation rule of paragraph (g) of this section does not apply, the value of a flight on an employer-provided piloted aircraft is determined under the general valuation principles set forth in this paragraph.

(ii) *Value of flight.* If an employee takes a flight on an employer-provided piloted aircraft and that employee's flight is primarily personal (see § 1.162–2(b)(2)), the value of the flight is equal to the amount that an individual would have to pay in an arm's-length transaction to charter the same or a comparable piloted aircraft for that period for the same or a comparable flight. A flight taken under these circumstances may not be valued by reference to the cost of commercial airfare for the same or a comparable flight. The cost to charter the aircraft must be allocated among all employees on board the aircraft based on all the facts and circumstances unless one or more of the employees controlled the use of the aircraft. Where one or more employees control the use of the aircraft, the value of the flight shall be allocated solely among such controlling employees, unless a written agreement among all the employees on the flight otherwise allocates the value of such flight. Notwithstanding the allocation required by the preceding sentence, no additional amount shall be included in the income of any employee whose flight is properly valued under the special valuation rule of paragraph (g) of this section. For purposes of this paragraph (b)(6), "control" means the ability of the employee to determine the route, departure time and destination of the flight. The rules provided in paragraph (g)(3) of this section will be used for purposes of this section in defining a flight. Notwithstanding the allocation required by the preceding sentence, no additional amount shall be included in the income of an employee for that portion of any such flight which is excludible from income pursuant to section 132(d) or § 1.132–5 as a working condition fringe.

(iii) *Examples.* The rules of paragraph (b)(6) of this section may be illustrated by the following examples:

Example (1). An employer makes available to employees A and B a piloted aircraft in New York, New York. A wants to go to Los Angeles, California for personal purposes. B

needs to go to Chicago, Illinois for business purposes, and then wants to go to Los Angeles, California for personal purposes. Therefore, the aircraft first flies to Chicago, and B deplanes and then boards the plane again. The aircraft then flies to Los Angeles, California where A and B deplane. The value of the flight to employee A will be no more than the amount that an individual would have to pay in an arm's length transaction to charter the same or a comparable piloted aircraft for the same or comparable flight from New York City to Los Angeles. No amount will be imputed to employee A for the stop at Chicago. As to employee B, the value of the personal flight will be no more than the value or the flight from Chicago to Los Angeles. Pursuant to the rules set forth in § 1.132-5(k), the flight from New York to Chicago will not be included in employee B's income since that flight was taken solely for business purposes. The charter cost must be allocated between A and B, since both employees controlled portions of the flight. Assume that the employer allocates according to the relative value of each employee's flight. If the charter value of A's flight from New York City to Los Angeles is $1,000 and the value of B's flight from Chicago to Los Angeles is $600 and the value of the actual flight from New York to Chicago to Los Angeles is $1,200, then the amount to be allocated to employee A is $750 ($1,000/($1,000+$600)×$1,200) and the amount to be allocated to employee B is $450 ($600/($1000+$600)×$1,200).

Example (2). Assume the same facts as in example (1), except that employee A also deplanes at Chicago, Illinois, but for personal purposes. The value of the flight to employee A then becomes the value of a flight from New York to Chicago to Los Angeles, i.e., $1,200. Therefore, the amount to be allocated to employee A is $800 ($1,200/($1,200+$600)×$1,200) and the amount to be allocated to employee B is $400 ($600/($1,200+$600)×$1,200).

(7) *Fair market value of the use of an employer-provided aircraft for which the employer does not furnish a pilot.* (i) *In general.* If the non-commercial flight special valuation rule of paragraph (g) of this section does not apply and if an employer provides an employee with the use of an aircraft without a pilot, the value of the use of the employer-provided aircraft is determined under the general valuation principles set forth in this paragraph (b)(7).

(ii) *Value of flight.* In general, if an employee takes a flight on an employer-provided aircraft for which the employer does not furnish a pilot, the value of that flight is equal to the amount that an individual would have to pay in an arm's-length transaction to lease the same or comparable aircraft on the same or comparable terms for the same period in the geographic area in which the aircraft is used. For example, if an employer makes its aircraft available to an employee who will pilot the aircraft for a two-hour flight, the value of the use of the aircraft is the amount that an individual would have to pay in an arm's-length transaction to rent a comparable aircraft for that period in the geographic area in which the aircraft is used. As another example, assume that an employee uses an employer-provided aircraft to commute between home and work. The value of the use of the aircraft is the amount that an individual would have to pay in an arm's-length transaction to rent a comparable aircraft for commuting in the geographic area in which the aircraft is used. If the availability of the flight is of benefit to more than one employee, then such value shall be allocated among such employees on the basis of the relevant facts and circumstances.

(c) *Special valuation rule*—(1) *In general.* Paragraphs (d) through (j) of this section provide special valuation rules that may be used under certain circumstances for certain commonly provided fringe benefits. For general rules relating to the valuation of fringe benefits not eligible for valuation under the special valuation rules, see paragraph (b) of this section.

(2) *Use of the special valuation rules*—(i) *In general.* The special valuation rules may be used for income tax, employment tax, and reporting purposes. The employer has the option to use any of the special valuation rules. However, an employee may only use a special valuation rule if the employer uses the rule. Moreover, an employee may only use the special rule that the employer uses to value the benefit provided; the employee may not use another special rule to value that benefit. The employee may always use general valuation rules based on facts and circumstances (see paragraph (b) of this section) even if the employer uses a special rule. If a special rule is used, it must be used for all purposes. If an employer properly uses a special rule and the employee uses the special rule, the employee must include in gross income the amount determined by the employer under the special rule reduced by the sum of—

(A) Any amount reimbursed by the employee to the employer, and

(B) Any amount excludable from income under another section of subtitle A of the Internal Revenue Code of 1986. If an employer properly uses a special rule and properly determines the amount of an employee's working condition fringe under section 132 and § 1.132-5 (under the general rule or under a special rule), and the employee uses the special valuation rule, the employee must include in gross income the amount determined by the employer less any amount reimbursed by the employee to the employer. The employer and employee may use the special rules to determine the amount of the reimbursement due the employer by the employee. Thus, if an employee reimburses an employer for the value of a benefit as determined under a special valuation rule, no amount is includable in the employee's gross income with respect to the benefit.

(ii) *Vehicle special valuation rules*—(A) *Vehicle by vehicle basis.* Except as provided in paragraphs (d)(7)(v) and (e)(5)(v) of this section, the vehicle special valuation rules of paragraphs (d), (e), and (f) of this section apply on a vehicle by vehicle basis. An employer need not use the same vehicle special valuation rule for all vehicles provided to all employees. For example, an employer may use the automobile lease valuation rule for automobiles provided to some employees, and the commuting and vehicle cents-per-mile valuation rules for automobiles provided to other employees. For purposes of valuing the use or availability of a vehicle, the consistency rules provided in paragraphs (d)(7) and (e)(5) of this section (relating to the automobile lease valuation rule and the vehicle cents-per-mile valuation rule, respectively) apply.

(B) *Shared vehicle usage.* If an employer provides a vehicle to employees for use by more than one employee at the same time, such as with an employer-sponsored vehicle commuting pool, the employer may use any of the special valuation rules that may be applicable to value the use of the vehicle by the employees. The employer must use the same special valuation rule to value the use of the vehicle by each employee who shares such use. The employer must allocate the value of the use of the vehicle based on the relevant facts and circumstances among the employees who share use of the vehicle. For example, assume that an employer provides an automobile to four of its employees and that the employees use the automobile in an employer-sponsored vehicle commuting pool. Assume further that the employer uses the automobile lease valuation rule of paragraph (d) of this section and that the Annual Lease Value of the automobile is $5,000.

The employer must treat $5,000 as the value of the availability of the automobile to the employees, and must apportion the $5,000 value among the employees who share the use of the automobile based on the relevant facts and circumstances. Each employee's share of the value of the availability of the automobile is then to be reduced by the amount, if any, of each employee's

working condition fringe exclusion and the amount reimbursed by the employee to the employer.

(iii) *Commercial and noncommercial flight valuation rules.* Except as otherwise provided, if either the commercial flight valuation rule or the non-commercial flight valuation rule is used, that rule must be used by an employer to value all eligible flights taken by all employees in a calendar year. See paragraph (g)(14) of this section for the applicable consistency rules.

(3) *Election to use the special valuation rules*—(i) *In general.* A particular special valuation rule is deemed to have been elected by the employer (and, if applicable, by the employee), if the employer (and, if applicable, the employee) determines the value of the fringe benefit provided by applying the special valuation rule and treats that value as the fair market value of the fringe benefit for income, employment tax, and reporting purposes. Neither the employer nor the employee must notify the Internal Revenue Service of the election.

(ii) *Notification to employee.* (A) *Requirement to provide notice.* An employer who elects to use a special valuation rule must notify the employee of the election by the later of January 31 of the calendar year for which the election is to apply, October 31 for calendar year 1989 or 30 days after the employer first provides the benefit to the employee. If an employer elected to use a special valuation rule for the immediately preceding calendar year and notified the affected employee in the manner prescribed by this paragraph (c)(3)(ii), then the employer need not notify the employee that the employer elects to continue using the same special valuation rule. If, consistent with the rules of paragraphs (d)(7) and (e)(5) of this section, an employer elects to discontinue using a special valuation rule and either elects to use another special valuation rule or applies general valuation principles to determine the value of the employer-provided benefit, the employer must notify the affected employee of the change in election in the manner prescribed by this paragraph (c)(3)(ii).

(B) *Content of notice.* The notice required by this paragraph (c)(3)(ii) must state that an employer is electing to use a special valuation rule for valuing a benefit provided to an employee (or is discontinuing the use of such a rule if that is the case). The notice must also alert employees to any applicable section 274(d) substantiation requirements and to the effect of failure to comply with such requirements. In addition, the notice must state the date on which the notice is provided. If an employer is not certain which vehicle special valuation rule will be applied with respect to a particular employer-provided vehicle, the employer must notify the affected employee of the special valuation rules that the employer may apply. For example, if an employer intends to use either the automobile lease valuation rule or the vehicle cents-per-mile valuation rule depending upon which rule yields a lesser amount of taxable income with respect to the use of a particular vehicle (or, alternatively, with respect to the use of a specific group of vehicles), the employer must notify the affected employee that the employer elects to use either of the specified valuation rules depending on which rule yields a lesser amount of taxable income with respect to the vehicle (or, alternatively, with respect to the specified group of vehicles).

(C) *Manner of providing notification to employee.* The notice required by this paragraph (c)(3)(ii) must be provided in a manner reasonably expected to come to the attention of all affected employees. For example, this may be accomplished by providing the notice directly to the employee in a mailing or with the employee's paycheck, or by posting the notice at a location where there is a strong likelihood that the notice will be read by all affected employees.

(D) *Failure to provide notice.* Except as provided in this paragraph (c)(3)(ii)(D), with respect to benefits provided in a calendar year, if an employer does not provide notice of an election to use a special valuation rule at the time and in the manner prescribed by this paragraph (c)(3)(ii), the employer may not use any such special valuation rule or any related special valuation rule to value the benefit provided in such year to employees who were not so notified but rather must use general valuation principles. However, if before January 31 of the year following the year in which notice was not provided, the employer receives written notification from an employee who was not notified, and such notification clearly indicates that the employee knows of

(*1*) The employer's use of a special valuation rule,

(*2*) The substantiation requirements that apply with respect to the special valuation rule, and

(*3*) The effect of a failure to comply with such requirements,

the employer may use the special valuation rule identified in the written employee notification with respect to the benefit provided to such employee. The rules set out in this paragraph (d)(3)(ii)(D) also apply, with appropriate adjustments, when an employer is discontinuing the use of a special valuation rule.

(4) *Application of section 414 to employers.* For purposes of paragraphs (c) through (j) of this section, except as otherwise provided therein, the term "employer" includes all entities required to be treated as a single employer under section 414 (b), (c), (m), or (o).

(5) *Valuation formulae contained in the special valuation rules.* The valuation formula contained in the special valuation rules are provided only for use in connection with those rules. Thus, when a special valuation rule is properly applied to a fringe benefit, the Commissioner will accept the value calculated pursuant to the rule as the fair market value of that fringe benefit. However, when a special valuation rule is not properly applied to a fringe benefit (see, for example, paragraph (g)(13) of this section), or when a special valuation rule is used to value a fringe benefit by a taxpayer not entitled to use the rule, the fair market value of that fringe benefit may not be determined by reference to any value calculated under any special valuation rule. Under the circumstances described in the preceding sentence, the fair market value of the fringe benefit must be determined pursuant to the general valuation rules of paragraph (b) of this section.

(6) *Modification of the special valuation rules.* The Commissioner may, to the extent necessary for tax administration, add, delete, or modify any special valuation rule, including the valuation formulae contained herein, on a prospective basis by regulation, revenue ruling or revenue procedure.

(7) *Special accounting rule.* If the employer is using the special accounting rule provided in Announcement 85–113 (1985–31 I.R.B. 31, August 5, 1985) (relating to the reporting of and withholding on the value of noncash fringe benefits), benefits which are deemed provided in a subsequent calendar year pursuant to that rule are considered as provided in that subsequent calendar year for purposes of the special valuation rules (including the notice requirements). Thus, if a particular special valuation rule is in effect for a calendar year, it applies to benefits deemed provided during that calendar year under the special accounting rule.

(d) *Automobile lease valuation rule*—(1) *In general*—(i) *Annual Lease Value.* Under the special valuation rule of this paragraph (d), if an employer provides

an employee with an automobile that is available to the employee for an entire calendar year, the value of the benefit provided is the Annual Lease Value (determined under paragraph (d)(2) of this section) of that automobile. Except as otherwise provided, for an automobile that is available to an employee for less than an entire calendar year, the value of the benefit provided is either a pro-rated Annual Lease Value or the Daily Lease Value (both as defined in paragraph (d)(4) of this section), whichever is applicable. Absent any statutory exclusion relating to the employer-provided automobile (see, for example, section 132(a)(3) and § 1.132-5(b)), the amount of the Annual Lease Value (or a pro-rated Annual Lease Value or the Daily Lease Value, as applicable) is included in the gross income of the employee.

(ii) *Definition of automobile.* For purposes of this paragraph (d), the term "automobile" means any four-wheeled vehicle manufactured primarily for use on public streets, roads, and highways.

(2) *Calculation of Annual Lease Value*—(i) *In general.* The Annual Lease Value of a particular automobile is calculated as follows:

(A) Determine the fair market value of the automobile as of the first date on which the automobile is made available to any employee of the employer for personal use. For an automobile first made available to any employee for personal use prior to January 1, 1985, determine the fair market value as of January 1 of the first year the special valuation rule of this paragraph (d) is used with respect to the automobile. For rules relating to determination of the fair market value of an automobile for purposes of this paragraph (d), see paragraph (d)(5) of this section.

(B) Select the dollar range in column 1 of the Annual Lease Value Table, set forth in paragraph (d)(2)(iii) of this section corresponding to the fair market value of the automobile. Except as otherwise provided in paragraphs (d)(2)(iv) and (v) of this section, the Annual Lease Value for each year of availability of the automobile is the corresponding amount in column 2 of the Table.

(ii) *Calculation of Annual Lease Value of automobile owned or leased by both an employer and an employee*—(A) *Purchased automobiles.* Notwithstanding anything in this section to the contrary, if an employee contributes an amount toward the purchase price of an automobile in return for a percentage ownership interest in the automobile, the Annual Lease Value or the Daily Lease Value, whichever is applicable, is determined by reducing the fair market value of the employer-provided automobile by the lesser of—

(*1*) The amount contributed, or

(*2*) An amount equal to the employee's percentage ownership interest multiplied by the unreduced fair market value of the automobile.

If the automobile is subsequently revalued, the revalued amount (determined without regard to this paragraph (d)(2)(ii)(A)) is reduced by an amount which is equal to the employee's percentage ownership interest in the vehicle). If the employee does not receive an ownership interest in the employer-provided automobile, then the Annual Lease Value or the Daily Lease Value, whichever is applicable, is determined without regard to any amount contributed. For purposes of this paragraph (d)(2)(ii)(A), an employee's ownership interest in an automobile will not be recognized unless it is reflected in the title of the automobile. An ownership interest reflected in the title of an automobile will not be recognized if under the facts and circumstances the title does not reflect the benefits and burdens of ownership.

(B) *Leased automobiles.* Notwithstanding anything in this section to the contrary, if an employee contributes an amount toward the cost to lease an automobile in return for a percentage interest in the automobile lease, the Annual Lease Value or the Daily Lease Value, whichever is applicable, is determined by reducing the fair market value of the employer-provided automobile by the amount specified in the following sentence. The amount specified in this sentence is the unreduced fair market value of a vehicle multiplied by the lesser of—

(*1*) The employee's percentage interest in the lease, or

(*2*) A fraction, the numerator of which is the amount contributed and the denominator of which is the entire lease cost.

If the automobile is subsequently revalued, the revalued amount (determined without regard to this paragraph (d)(2)(ii)(B)) is reduced by an amount which is equal to the employee's percentage interest in the lease) multiplied by the revalued amount. If the employee does not receive an interest in the automobile lease, then the Annual Lease Value or the Daily Lease Value, whichever is applicable, is determined without regard to any amount contributed. For purposes of this paragraph (d)(2)(ii)(B), an employee's interest in an automobile lease will not be recognized unless the employee is a named co-lessee on the lease. An interest in a lease will not be recognized if under the facts and circumstances the lease does not reflect the true obligations of the lessees.

(C) *Example.* The rules of paragraph (d)(2)(ii) (A) and (B) of this section are illustrated by the following example:

Example. Assume that an employer pays $15,000 and an employee pays $5,000 toward the purchase of an automobile. Assume further that the employee receives a 25 percent interest in the automobile and is named as a co-owner on the title to the automobile. Under the rule of paragraph (d)(2)(ii)(A) of this section, the Annual Lease Value of the automobile is determined by reducing the fair market value of the automobile ($20,000) by the $5,000 employee contribution. Thus, the Annual Lease Value of the automobile under the table in paragraph (d)(2)(iii) of this section is $4,350. If the employee in this example does not receive an ownership interest in the automobile and is provided the use of the automobile for two years, the Annual Lease Value would be determined without regard to the $5,000 employee contribution. Thus, the Annual Lease Value would be $5,600. The $5,000 employee contribution would reduce the amount includible in the employee's income after taking into account the amount, if any, excluded from income under another provision of subtitle A of the Internal Revenue Code, such as the working condition fringe exclusion. Thus, if the employee places 50 percent of the mileage on the automobile for the employer's business each year, then the amount includible in the employee's income in the first year would be ($5,600–2,800–2,800), or $0, the amount includible in the employee's income in the second year would be ($5,600–2,800–2,200 ($5,000–2,800)) or $600 and the amount includible in the third year would be ($5,600–2,800) or $2,800 since the employee's contribution has been completely used in the first two years.

(iii) *Annual Lease Value Table.*

Automobile fair market value (1)	Annual lease value (2)
$0 to 999	$600
1,000 to 1,999	850
2,000 to 2,999	1,100
3,000 to 3,999	1,350
4,000 to 4,999	1,600
5,000 to 5,999	1,850
6,000 to 6,999	2,100
7,000 to 7,999	2,350
8,000 to 8,999	2,600
9,000 to 9,999	2,850
10,000 to 10,999	3,100
11,000 to 11,999	3,350
12,000 to 12,999	3,600
13,000 to 13,999	3,850
14,000 to 14,999	4,100
15,000 to 15,999	4,350
16,000 to 16,999	4,600
17,000 to 17,999	4,850
18,000 to 18,999	5,100
19,000 to 19,999	5,350
20,000 to 20,999	5,600
21,000 to 21,999	5,850
22,000 to 22,999	6,100
23,000 to 23,999	6,350

Automobile fair market value (1)	Annual lease value (2)
24,000 to 24,999	6,600
25,000 to 25,999	6,850
26,000 to 27,999	7,250
28,000 to 29,999	7,750
30,000 to 31,999	8,250
32,000 to 33,999	8,750
34,000 to 35,999	9,250
36,000 to 37,999	9,750
38,000 to 39,999	10,250
40,000 to 41,999	10,750
42,000 to 43,999	11,250
44,000 to 45,999	11,750
46,000 to 47,999	12,250
48,000 to 49,999	12,750
50,000 to 51,999	13,250
52,000 to 53,999	13,750
54,000 to 55,999	14,250
56,000 to 57,999	14,750
58,000 to 59,999	15,250

For vehicles having a fair market value in excess of $59,999, the Annual Lease Value is equal to: (.25 × the fair market value of the automobile) + $500.

(iv) *Recalculation of Annual Lease Value.* The Annual Lease Values determined under the rules of this paragraph (d) are based on four-year lease terms. Therefore, except as otherwise provided in paragraph (d)(2)(v) of this section, the Annual Lease Value calculated by applying paragraph (d)(2) (i) or (ii) of this section shall remain in effect for the period that begins with the first date the special valuation rule of paragraph (d) of this section is applied by the employer to the automobile and ends on December 31 of the fourth full calendar year following that date. The Annual Lease Value for each subsequent four-year period is calculated by determining the fair market value of the automobile as of the first January 1 following the period described in the previous sentence and selecting the amount in column 2 of the Annual Lease Value Table corresponding to the appropriate dollar range in column 1 of the Table. If, however, the employer is using the special accounting rule provided in Announcement 85–113 (1985–31 I.R.B. 31, August 5, 1985) (relating to the reporting of and withholding on the value of noncash fringe benefits), the employer may calculate the Annual Lease Value for each subsequent four-year period as of the beginning of the special accounting period that begins immediately prior to the January 1 described in the previous sentence. For example, assume that pursuant to Announcement 85–113, an employer uses the special accounting rule. Assume further that beginning on November 1, 1988, the special accounting period is November 1 to October 31 and that the employer elects to use the special valuation rule of this paragraph (d) as of January 1, 1989. The employer may recalculate the Annual Lease Value as of November 1, 1992, rather than as of January 1, 1993.

(v) *Transfer of the automobile to another employee.* Unless the primary purpose of the transfer is to reduce Federal taxes, if an employer transfers the use of an automobile from one employee to another employee, the employer may recalculate the Annual Lease Value based on the fair market value of the automobile as of January 1 of the calendar year of transfer. If, however, the employer is using the special accounting rule provided in Announcement 85–113 (1985–31 I.R.B. 31, August 5, 1985) (relating to the reporting of and withholding on the value of noncash fringe benefits), the employer may recalculate the Annual Lease Value based on the fair market value of the automobile as of the beginning of the special accounting period in which the transfer occurs. If the employer does not recalculate the Annual Lease Value, and the employee to whom the automobile is transferred uses the special valuation rule, the employee may not recalculate the Annual Lease Value.

(3) *Services included in, or excluded from, the Annual Lease Value Table*—(i) *Maintenance and insurance included.* The Annual Lease Values contained in the Annual Lease Value Table include the fair market value of maintenance of, and insurance for, the automobile. Neither an employer nor an employee may reduce the Annual Lease Value by the fair market value of any service included in the Annual Lease Value that is not provided by the employer, such as reducing the Annual Lease Value by the fair market value of a maintenance service contract or insurance. An employer or employee who wishes to take into account only the services actually provided with respect to an automobile may value the availability of the automobile under the general valuation rules of paragraph (b) of this section.

(ii) *Fuel excluded*—(A) *In general.* The Annual Lease Values do not include the fair market value of fuel provided by the employer, whether fuel is provided in kind or its cost is reimbursed by or charged to the employer. Thus, if an employer provides fuel, the fuel must be valued separately for inclusion in income.

(B) *Valuation of fuel provided in kind.* The provision of fuel in kind may be valued at fair market value based on all the facts and circumstances or, in the alternative, it may be valued at 5.5 cents per mile for all miles driven by the employee. However, the provision of fuel in kind may not be valued at 5.5 cents per mile for miles driven outside the United States, Canada or Mexico. For purposes of this section, the United States includes the United States, its possessions and its territories.

(C) *Valuation of fuel where cost reimbursed by or charged to an employer.* The fair market value of fuel, the cost of which is reimbursed by or charged to an employer, is generally the amount of the actual reimbursement or the amount charged, provided the purchase of the fuel is at arm's-length.

(D) *Fleet-average cents-per-mile fuel cost.* If an employer with a fleet of at least 20 automobiles that meets the requirements of paragraph (d)(5)(v)(D) of this section reimburses employees for the cost of fuel or allows employees to charge the employer for the cost of fuel, the fair market value of fuel provided to those automobiles may be determined by reference to the employer's fleet-average cents-per-mile fuel cost. The fleet-average cents-per-mile fuel cost is equal to the fleet-average per-gallon fuel cost divided by the fleet-average miles-per-gallon rate. The averages described in the preceding sentence must be determined by averaging the per-gallon fuel costs and miles-per-gallon rates of a representative sample of the automobiles in the fleet equal to the greater of ten percent of the automobiles in the fleet or 20 automobiles for a representative period, such as a two-month period. In lieu of determining the fleet-average cents-per-mile fuel cost, if an employer is using the fleet-average valuation rule of paragraph (d)(5)(v) of this section and if determining the amount of the actual reimbursement or the amount charged for the purchase of fuel would impose unreasonable administrative burdens on the employer, the provision of fuel may be valued under the rule provided in paragraph (d)(3)(ii)(B) of this section.

(iii) *Treatment of other services.* The fair market value of any service not specifically identified in paragraph (d)(3)(i) of this section that is provided by the employer with respect to an automobile (other than the services of a chauffeur) must be added to the Annual Lease Value of the automobile in determining the fair market value of the benefit provided. See paragraph (b) (5) of this section for rules relating to the valuation of chauffeur services.

(4) *Availability of an automobile for less than an entire calendar year*—(i) *Pro-rated Annual Lease Value used for continuous availability of at least 30 days*—(A) *In general.* Except as

otherwise provided in paragraph (d)(4)(iv) of this section, for periods of continuous availability of at least 30 days, but less than an entire calendar year, the value of the availability of an automobile provided by an employer electing to use the automobile lease valuation rule of this paragraph (d) is the pro-rated Annual Lease Value. The pro-rated Annual Lease Value is calculated by multiplying the applicable Annual Lease Value by a fraction, the numerator of which is the number of days of availability and the denominator of which is 365.

(B) *Special rule for continuous availability of at least 30 days that straddles two reporting years.* If an employee is provided with the continuous availability of an automobile for at least 30 days, but the continuous period straddles two calendar years (or two special accounting periods if the special accounting rule of Announcement 85–113 (1985–31 I.R.B. 31, August 5, 1985) (relating to the reporting of and withholding on noncash fringe benefits) is used), the pro-rated Annual Lease Value, rather than the Daily Lease Value, may be applied with respect to such period of continuous availability.

(ii) *Daily Lease Value used for continuous availability of less than 30 days.* Except as otherwise provided in paragraph (d)(4)(iii) of this section, for periods of continuous availability of one or more but less than 30 days, the value of the availability of the employer-provided automobile is the Daily Lease Value. The Daily Lease Value is calculated by multiplying the applicable Annual Lease Value by a fraction, the numerator of which is four times the number of days of availability and the denominator of which is 365.

(iii) *Election to treat all periods as periods of at least 30 days.* The value of the availability of an employer-provided automobile for a period of continuous availability of less than 30 days may be determined by applying the pro-rated Annual Lease Value by treating the automobile as if it had been available for 30 days, if doing so would result in a lower valuation than applying the Daily Lease Value to the shorter period of actual availability.

(iv) *Periods of unavailability*—(A) *General rule.* In general, a pro-rated Annual Lease Value (as provided in paragraph (d)(4)(i) of this section) is used to value the availability of an employer-provided automobile when the automobile is available to an employee for a continuous period of at least 30 days but less than the entire calendar year. Neither an employer nor an employee, however, may use a pro-rated Annual Lease Value when the reduction of Federal taxes is the primary reason the automobile is unavailable to an employee at certain times during the calendar year.

(B) *Unavailability for personal reasons of the employee.* If an automobile is unavailable to an employee because of personal reasons of the employee, such as while the employee is on vacation, a pro-rated Annual Lease Value, if used, must not take into account such periods of unavailability. For example, assume that an automobile is available to an employee during the first five months of the year and during the last five months of the year. Assume further that the period of unavailability occurs because the employee is on vacation. The Annual Lease Value, if it is applied, must be applied with respect to the entire 12-month period. The Annual Lease Value may not be pro-rated to take into account the two-month period of unavailability.

(5) *Fair market value*—(i) *In general.* For purposes of determining the Annual Lease Value of an automobile under the Annual Lease Value Table, the fair market value of an automobile is the amount that an individual would have to pay in an arm's-length transaction to purchase the particular automobile in the jurisdiction in which the vehicle is purchased or leased. That amount includes all amounts attributable to the purchase of an automobile such as sales tax and title fees as well as the purchase price of the automobile. Any special relationship that may exist between the employee and the employer must be disregarded. Also, the employee's subjective perception of the value of the automobile is not relevant to the determination of the automobile's fair market value, and, except as provided in paragraph (d)(5)(ii) of this section, the cost incurred by the employer in connection with the purchase or lease of the automobile is not determinative of the fair market value of the automobile.

(ii) *Safe-harbor valuation rule*—(A) *General rule.* For purposes of calculating the Annual Lease Value of an automobile under this paragraph (d), the safe-harbor value of the automobile may be used as the fair market value of the automobile.

(B) *Automobiles owned by the employer.* For an automobile owned by the employer, the safe-harbor value of the automobile is the employer's cost of purchasing the automobile (including sales tax, title, and other expenses attributable to such purchase), provided the purchase is made at arm's-length. Notwithstanding the preceding sentence, the safe-harbor value of this paragraph (d)(5)(ii)(B) is not available with respect to an automobile manufactured by the employer. Thus, for example, if one entity manufactures an automobile and sells it to an entity with which it is aggregated pursuant to paragraph (c)(4) of this section, this paragraph (d)(5)(ii)(B) does not apply to value the automobile by the aggregated employer. In this case, value must be determined under paragraph (d)(5)(i) of this section.

(C) *Automobiles leased by the employer.* For an automobile leased but not manufactured by the employer, the safe-harbor value of the automobile is either the manufacturer's suggested retail price of the automobile less eight percent (including sales tax, title, and other expenses attributable to such purchase), or the value determined under paragraph (d)(5)(iii) of this section.

(iii) *Use of nationally recognized pricing sources.* The fair market value of an automobile that is—

(A) Provided to an employee prior to January 1, 1985,

(B) Being revalued pursuant to paragraphs (d)(2) (iv) or (v) of this section, or

(C) A leased automobile being valued pursuant to paragraph (d)(5)(ii) of this section, may be determined by reference to the retail value of such automobile as reported by a nationally recognized pricing source that regularly reports new or used automobile retail values, whichever is applicable. That retail value must be reasonable with respect to the automobile being valued. Pricing sources consist of publications and electronic data bases.

(iv) *Fair market value of special equipment.* When determining the fair market value of an automobile, the employer may exclude the fair market value of any specialized equipment or telephone that is added to or carried in the automobile provided that the presence of that equipment or telephone is necessitated by, and attributable to, the business needs of the employer. The value of the specialized equipment must be included if the employee to whom the automobile is available uses the specialized equipment in a trade or business of the employee other than the employee's trade or business of being an employee of the employer.

(v) *Fleet-average valuation rule*—(A) *In general.* An employer with a fleet of 20 or more automobiles meeting the requirements of this paragraph (d)(5)(v) (including the business-use and fair market value conditions of paragraph (d)(5)(v)(D) of this section) may use a fleet-average value for purposes of calculating the Annual Lease Values of the automobiles in the fleet. The fleet-

average value is the average of the fair market values of all automobiles in the fleet. The fair market value of each automobile in the fleet shall be determined, pursuant to the rules of paragraphs (d)(5) (i) through (iv) of this section, as of the date described in paragraph (d)(2)(i)(A) of this section.

(B) *Period for use of rule.* The fleet-average valuation rule of this paragraph (d)(5)(v) may be used by an employer as of January 1 of any calendar year following the calendar year in which the employer acquires a sufficient number of automobiles to total a fleet of 20 or more automobiles. The Annual Lease Value calculated for the automobiles in the fleet, based on the fleet-average value, shall remain in effect for the period that begins with the first January 1 the fleet-average valuation rule of this paragraph (d)(5)(v) is applied by the employer to the automobiles in the fleet and ends on December 31 of the subsequent calendar year. The Annual Lease Value for each subsequent two-year period is calculated by determining the fleet-average value of the automobiles in the fleet as of the first January 1 of such period. An employer may cease using the fleet-average valuation rule as of any January 1. If, however, the employer is using the special accounting rule provided in Announcement 85–113 (1985–31 I.R.B. 31, August 5, 1985) (relating to the reporting of and withholding on noncash fringe benefits), the employer may apply the rules of this paragraph (d)(5)(v)(B) on the basis of the special accounting period rather than the calendar year. (This is accomplished by substituting (*1*) the beginning of the special accounting period that begins immediately prior to the January 1 described in this paragraph (d)(5)(v)(B) for January 1 wherever it appears in this paragraph (d)(5)(v) (B) and (*2*) the end of such accounting period for December 31.) If the number of qualifying automobiles in the employer's fleet declines to fewer than 20 for more than 50 percent of the days in a year, then the fleet-average valuation rule does not apply as of January 1 of such year. In this case, the Annual Lease Value must be determined separately for each remaining automobile. The revaluation rules of paragraph (d)(2) (iv) and (v) of this section do not apply to automobiles valued under this paragraph (d)(5)(v).

(C) *Automobiles included in the fleet.* An employer may include in a fleet any automobile that meets the requirements of this paragraph (d)(5)(v) and is available to any employee of the employer for personal use. An employer may include in the fleet only automobiles the availability of which is valued under the automobile lease valuation rule of this paragraph (d). An employer need not include in the fleet all automobiles valued under the automobile lease valuation rule. An employer may have more than one fleet for purposes of the fleet-average rule of this paragraph (d)(5)(v). For example, an employer may group automobiles in a fleet according to their physical type or use.

(D) *Limitations on use of fleet-average rule.* The rule provided in this paragraph (d)(5)(v) may not be used for any automobile the fair market value of which (determined pursuant to paragraphs (d)(5) (i) through (iv) of this section as of either the first date on which the automobile is made available to any employee of the employer for personal use or, if later, January 1, 1985) exceeds $16,500. The fair market value limitation of $16,500 shall be adjusted pursuant to section 280F(d)(7) of the Internal Revenue Code of 1986. The first such adjustment shall be for calendar year 1989 (substitute October 1986 for October 1987 in applying the formula). In addition, the rule provided in this paragraph (d)(5)(v) may only be used for automobiles that the employer reasonably expects will regularly be used in the employer's trade or business. For rules concerning when an automobile is regularly used in the employer's business, see paragraph (e)(1)(iv) of this section.

(E) *Additional automobiles added to the fleet.* The fleet-average value in effect at the time an automobile is added to a fleet is treated as the fair market value of the additional automobile for purposes of determining the Annual Lease Value of the automobile until the fleet-average value changes pursuant to paragraph (d)(5)(v)(B) of this section.

(F) *Use of the fleet-average rule by employees.* An employee may only use the fleet-average rule if it is used by the employer. If an employer uses the fleet-average rule, and the employee uses the special valuation rule of paragraph (d) of this section, the employee must use the fleet-average value determined by the employer.

(6) *Special rules for continuous availability of certain automobiles*—(i) *Fleet automobiles.* If an employer is using the fleet-average valuation rule of paragraph (d)(5)(v) of this section and the employer provides an employee with the continuous availability of an automobile from the same fleet during a period (though not necessarily the same fleet automobile for the entire period), the employee is treated as having the use of a single fleet automobile for the entire period, e.g., an entire calendar year. Thus, when applying the automobile lease valuation rule of this paragraph (d), the employer may treat the fleet-average value as the fair market value of the automobile deemed available to the employee for the period for purposes of calculating the Annual Lease Value, (or pro-rated Annual Lease Value or Daily Lease Value whichever is applicable) of the automobile. If an employer provides an employee with the continuous availability of more than one fleet automobile during a period, the employer may treat the fleet-average value as the fair market value of each automobile provided to the employee provided that the rules of paragraph (d)(5)(v)(D) of this section are satisfied.

(ii) *Demonstration automobiles*—(A) *In general.* If an automobile dealership provides an employee with the continuous availability of a demonstration automobile (as defined in § 1.132–5(o)(3)) during a period (though not necessarily the same demonstration automobile for the entire period), the employee is treated as having the use of a single demonstration automobile for the entire period, e.g., an entire calendar year. If an employer provides an employee with the continuous availability of more than one demonstration automobile during a period, the employer may treat the value determined under paragraph (d)(6)(ii)(B) of this section as the fair market value of each automobile provided to the employee. For rules relating to the treatment as a working condition fringe of the qualified automobile demonstration use of a demonstration automobile by a full-time automobile salesman, see § 1.132–5(o).

(B) *Determining the fair market value of a demonstration automobile.* When applying the automobile lease valuation rule of this paragraph (d), the employer may treat the average of the fair market values of the demonstration automobiles which are available to an employee and held in the dealership's inventory during the calendar year as the fair market value of the demonstration automobile deemed available to the employee for the period for purposes of calculating the Annual Lease Value of the automobile. If under the facts and circumstances it is inappropriate to take into account, with respect to an employee, certain models of demonstration automobiles, the value of the benefit is determined without reference to the fair market values of such models. For example, assume that an employee has the continuous availability for an entire calendar year

of one demonstration automobile, although not the same one for the entire year. Assume further that the fair market values of the automobiles in the dealership inventory during the year range from $8,000 to $20,000. If there is not a substantial period (such as three months) during the year when the employee uses demonstration automobiles valued at less than $16,000, then those automobiles are not considered in determining the value of the benefit provided to the employee. In this case, the average of the fair market values of the demonstration automobiles in the dealership's inventory valued at $16,000 or more is treated as the fair market value of the automobile deemed available to the employee for the calendar year for purposes of calculating the Annual Lease Value of the automobile.

(7) *Consistency rules*—(i) *Use of the automobile lease valuation rule by an employer.* Except as provided in paragraph (d)(5)(v)(B) of this section, an employer may adopt the automobile lease valuation rule of this paragraph (d) for an automobile only if the rule is adopted to take effect by the later of—

(A) January 1, 1989, or

(B) The first day on which the automobile is made available to an employee of the employer for personal use (or, if the commuting valuation rule of paragraph (f) of this section is used when the automobile is first made available to an employee of the employer for personal use, the first day on which the commuting valuation rule is not used).

(ii) *An employer must use the automobile lease valuation rule for all subsequent years.* Once the automobile lease valuation rule has been adopted for an automobile by an employer, the rule must be used by the employer for all subsequent years in which the employer makes the automobile available to any employee except that the employer may, for any year during which (or for any employee for whom) use of the automobile qualifies for the commuting valuation rule of paragraph (f) of this section, use the commuting valuation rule with respect to the automobile.

(iii) *Use of the automobile lease valuation rule by an employee.* An employee may adopt the automobile lease valuation rule for an automobile only if the rule is adopted—

(A) By the employer, and

(B) Beginning with the first day on which the automobile for which the employer (consistent with paragraph (d)(7)(i) of this section) adopted the rule is made available to that employee for personal use (or, if the commuting valuation rule of paragraph (f) of this section is used when the automobile is first made available to that employee for personal use, the first day on which the commuting valuation rule is not used).

(iv) *An employee must use the automobile lease valuation rule for all subsequent years.* Once the automobile lease valuation rule has been adopted for an automobile by an employee, the rule must be used by the employee for all subsequent years in which the automobile for which the rule is used is available to the employee. However, the employee may, for any year during which use of the automobile qualifies for use of the commuting valuation rule of paragraph (f) of this section and for which the employer uses such rule, use the commuting valuation rule with respect to the automobile.

(v) *Replacement automobiles.* Notwithstanding anything in this paragraph (d)(7) to the contrary, if the automobile lease valuation rule is used by an employer, or by an employer and an employee, with respect to a particular automobile, and a replacement automobile is provided to the employee for the primary purpose of reducing Federal taxes, then the employer, or the employer and the employee, using the rule must continue to use the rule with respect to the replacement automobile.

(e) *Vehicle cents-per-mile valuation rule*—(1) *In general*—(i) *General rule.* Under the vehicle cents-per-mile valuation rule of this paragraph (e), if an employer provides an employee with the use of a vehicle that—

(A) The employer reasonably expects will be regularly used in the employer's trade or business throughout the calendar year (or such shorter period as the vehicle may be owned or leased by the employer), or

(B) Satisfies the requirements of paragraph (e)(1)(ii) of this section, the value of the benefit provided in the calendar year is the standard mileage rate provided in the applicable Revenue Ruling or Revenue Procedure ("cents-per-mile rate") multiplied by the total number of miles the vehicle is driven by the employee for personal purposes. The cents-per-mile rate is to be applied prospectively from the first day of the taxable year following the date of publication of the applicable Revenue Ruling or Revenue Procedure. An employee who uses an employer-provided vehicle, in whole or in part, for a trade or business other than the employer's trade or business, may take a deduction for such business use based upon the vehicle cents-per-mile rule as long as such deduction is at the same standard mileage rate as that used in calculating the employee's income inclusion. The standard mileage rate must be applied to personal miles independent of business miles. Thus, for example, if the standard mileage rate were 24 cents per mile for the first 15,000 miles and 11 cents per mile for all miles over 15,000 and an employee drives 20,000 personal miles and 45,000 business miles in a year, the value of the personal use of the vehicle is $4,150 ((15,000×$.24)+(5,000×$.11)). For purposes of this section, the use of a vehicle for personal purposes is any use of the vehicle other than use in the employee's trade or business of being an employee of the employer.

(ii) *Mileage rule.* A vehicle satisfies the requirements of this paragraph (e)(1)(ii) for a calendar year if—

(A) It is actually driven at least 10,000 miles in that year; and

(B) Use of the vehicle during the year is primarily by employees. For example, if a vehicle is used by only one employee during the calendar year and that employee drives the vehicle at least 10,000 miles during the year, the vehicle satisfies the requirements of this paragraph (e)(1)(ii) even if all miles driven by the employee are personal. A vehicle is considered used during the year primarily by employees in accordance with the requirement of paragraph (e)(1)(ii)(B) of this section if employees use the vehicle on a consistent basis for commuting. If the employer does not own or lease the vehicle during a portion of the year, the 10,000 mile threshold is to be reduced proportionately to reflect the periods when the employer did not own or lease the vehicle. For purposes of this paragraph (e)(1)(ii), use of the vehicle by an individual (other than the employee) whose use would be taxed to the employee is not considered use by the employee.

(iii) *Limitation on use of the vehicle cents-per-mile valuation rule*—(A) *In general.* Except as otherwise provided in the last sentence of this paragraph (e)(1)(iii)(A), the value of the use of an automobile (as defined in paragraph (d)(1)(ii) of this section) may not be determined under the vehicle cents-per-mile valuation rule of this paragraph (e) for a calendar year if the fair market value of the automobile (determined pursuant to paragraphs (d)(5) (i) through (iv) of this section as of the later of January 1, 1985, or the first date on which the automobile is made available to any employee of the employer for personal use) exceeds the sum of the maximum recovery deductions allowable under section 280F(a)(2) for a five-year period for an automobile first

placed in service during that calendar year (whether or not the automobile is actually placed in service during that year) as adjusted by section 280F(d)(7). With respect to a vehicle placed in service prior to January 1, 1989, the limitation on value will be not less than $12,800. With respect to a vehicle placed in service in or after 1989, the limitation on value is $12,800 as adjusted by section 280F(d)(7).

(B) *Application of limitation with respect to a vehicle owned by both an employer and an employee.* If an employee contributes an amount towards the purchase price of a vehicle in return for a percentage ownership interest in the vehicle, for purposes of determining whether the limitation of this paragraph (e)(1)(iii) applies, the fair market value of the vehicle is reduced by the lesser of—

(*1*) The amount contributed, or

(*2*) An amount equal to the employee's percentage ownership interest multiplied by the unreduced fair market value of the vehicle. If the employee does not receive an ownership interest in the employer-provided vehicle, then the fair market value of the vehicle is determined without regard to any amount contributed. For purposes of this paragraph (e)(1)(iii)(B), an employee's ownership interest in a vehicle will not be recognized unless it is reflected in the title of the vehicle. An ownership interest reflected in the title of a vehicle will not be recognized if under the facts and circumstances the title does not reflect the benefits and burdens of ownership.

(C) *Application of limitation with respect to a vehicle leased by both an employer and employee.* If an employee contributes an amount toward the cost to lease a vehicle in return for a percentage interest in the vehicle lease, for purposes of determining whether the limitation of this paragraph (e)(1)(iii) applies, the fair market value of the vehicle is reduced by the amount specified in the following sentence. The amount specified in this sentence is the unreduced fair market value of a vehicle multiplied by the lesser of—

(*1*) The employee's percentage interest in the lease, or

(*2*) A fraction, the numerator of which is the amount contributed and the denominator of which is the entire lease cost. If the employee does not receive an interest in the vehicle lease, then the fair market value is determined without regard to any amount contributed. For purposes of this paragraph (e)(1)(iii)(C), an employee's interest in a vehicle lease will not be recognized unless the employee is a named co-lessee on the lease. An interest in a lease will not be recognized if under the facts and circumstances, the lease does not reflect the true obligations of the lessees.

(iv) *Regular use in an employer's trade or business.* Whether a vehicle is regularly used in an employer's trade or business is determined on the basis of all facts and circumstances. A vehicle is considered regularly used in an employer's trade or business for purposes of paragraph (e)(1)(i)(A) of this section if one of the following safe harbor conditions is satisfied:

(A) At least 50 percent of the vehicle's total annual mileage is for the employer's business; or

(B) The vehicle is generally used each workday to transport at least three employees of the employer to and from work in an employer-sponsored commuting vehicle pool. Infrequent business use of the vehicle, such as for occasional trips to the airport or between the employer's multiple business premises, does not constitute regular use of the vehicle in the employer's trade or business.

(v) *Application of rule to shared usage.* If an employer regularly provides a vehicle to employees for use by more than one employee at the same time, such as with an employer-sponsored vehicle commuting pool, the employer may use the vehicle cents-per-mile valuation rule to value the use of the vehicle by each employee who shares such use. See § 1.61–21(c)(2)(ii)(B) for provisions relating to the allocation of the value of an automobile to more than one employee.

(2) *Definition of vehicle.* For purposes of this paragraph (e), the term "vehicle" means any motorized wheeled vehicle manufactured primarily for use on public streets, roads, and highways. The term "vehicle" includes an automobile as defined in paragraph (d)(1)(ii) of this section.

(3) *Services included in, or excluded from, the cents-per-mile rate*—(i) *Maintenance and insurance included.* The cents-per-mile rate includes the fair market value of maintenance of, and insurance for, the vehicle. The cents-per-mile rate may not be reduced by the fair market value of any service included in the cents-per-mile rate but not provided by the employer. An employer or employee who wishes to take into account only the particular services provided with respect to a vehicle may value the availability of the vehicle under the general valuation rules of paragraph (b) of this section.

(ii) *Fuel provided by the employer*—(A) *Miles driven in the United States, Canada, or Mexico.* With respect to miles driven in the United States, Canada, or Mexico, the cents-per-mile rate includes the fair market value of fuel provided by the employer. If fuel is not provided by the employer, the cents-per-mile rate may be reduced by no more than 5.5 cents or the amount specified in any applicable Revenue Ruling or Revenue Procedure. For purposes of this section, the United States includes the United States, its possessions and its territories.

(B) *Miles driven outside the United States, Canada, or Mexico.* With respect to miles driven outside the United States, Canada, or Mexico, the fair market value of fuel provided by the employer is not reflected in the cents-per-mile rate. Accordingly, the cents-per-mile rate may be reduced but by no more than 5.5 cents or the amount specified in any applicable Revenue Ruling or Revenue Procedure. If the employer provides the fuel in kind, it must be valued based on all the facts and circumstances If the employer reimburses the employee for the cost of fuel or allows the employee to charge the employer for the cost of fuel, the fair market value of the fuel is generally the amount of the actual reimbursement or the amount charged, provided the purchase of fuel is at arm's length.

(iii) *Treatment of other services.* The fair market value of any service not specifically identified in paragraph (e)(3)(i) of this section that is provided by the employer with respect to a vehicle is not reflected in the cents-per-mile rate. See paragraph (b)(5) of this section for rules relating to valuation of chauffeur services.

(4) *Valuation of personal use only.* The vehicle cents-per-mile valuation rule of this paragraph (e) may only be used to value the miles driven for personal purposes. Thus, the employer must include an amount in an employee's income with respect to the use of a vehicle that is equal to the product of the number of personal miles driven by the employee and the appropriate cents-per-mile rate. The term "personal miles" means all miles for which the employee used the automobile except miles driven in the employee's trade or business of being an employee of the employer. Unless additional services are provided with respect to the vehicle (see paragraph (e)(3)(iii) of this section), the employer may not include in income a greater amount; for example, the employer may not include in income 100 percent (all business and personal miles) of the value of the use of the vehicle.

(5) *Consistency rules*—(i) *Use of the vehicle cents-per-mile valuation rule by an employer.* An employer must adopt the vehicle cents-per-mile valuation rule

of this paragraph (e) for a vehicle to take effect by the later of—

(A) January 1, 1989, or

(B) The first day on which the vehicle is used by an employee of the employer for personal use (or, if the commuting valuation rule of paragraph (f) of this section is used when the vehicle is first used by an employee of the employer for personal use, the first day on which the commuting valuation rule is not used).

(ii) *An employer must use the vehicle cents-per-mile valuation rule for all subsequent years.* Once the vehicle cents-per-mile valuation rule has been adopted for a vehicle by an employer, the rule must be used by the employer for all subsequent years in which the vehicle qualifies for use of the rule, except that the employer may, for any year during which use of the vehicle qualifies for the commuting valuation rule of paragraph (f) of this section, use the commuting valuation rule with respect to the vehicle. If the vehicle fails to qualify for use of the vehicle cents-per-mile valuation rule during a subsequent year, the employer may adopt for such subsequent year and thereafter any other special valuation rule for which the vehicle then qualifies. If the employer elects to use the automobile lease valuation rule of paragraph (d) of this section for a period in which the automobile does not qualify for use of the vehicle cents-per-mile valuation rule, then the employer must comply with the requirements of paragraph (d)(7) of this section. For purposes of paragraph (d)(7) of this section, the first day on which the automobile with respect to which the vehicle cents-per-mile rule had been used fails to qualify for use of the vehicle cents-per-mile valuation rule may be deemed to be the first day on which the automobile is available to an employee of the employer for personal use.

(iii) *Use of the vehicle cents-per-mile valuation rule by an employee.* An employee may adopt the vehicle cents-per-mile valuation rule for a vehicle only if the rule is adopted—

(A) By the employer, and

(B) Beginning with respect to the first day on which the vehicle for which the employer (consistent with paragraph (e)(5)(i) of this section) adopted the rule is available to that employee for personal use (or, if the commuting valuation rule of paragraph (f) of this section is used when the vehicle is first used by an employee for personal use, the first day on which the commuting valuation rule is not used).

(iv) *An employee must use the vehicle cents-per-mile valuation rule for all subsequent years.* Once the vehicle cents-per-mile valuation rule has been adopted for a vehicle by an employee, the rule must be used by the employee for all subsequent years of personal use of the vehicle by the employee for which the rule is used by the employer. However, see paragraph (f) of this section for rules relating to the use of the commuting valuation rule for a subsequent year.

(v) *Replacement vehicles.* Notwithstanding anything in this paragraph (e)(5) to the contrary, if the vehicle cents-per-mile valuation rule is used by an employer, or by an employer and an employee, with respect to a particular vehicle, and a replacement vehicle is provided to the employee for the primary purpose of reducing Federal taxes, then the employer, or the employer and the employee, using the rule must continue to use the rule with respect to the replacement vehicle if the replacement vehicle qualifies for use of the rule.

(f) *Commuting valuation rule*—(1) *In general.* Under the commuting valuation rule of this paragraph (f), the value of the commuting use of an employer-provided vehicle may be determined pursuant to paragraph (f)(3) of this section if the following criteria are met by the employer and employees with respect to the vehicle:

(i) The vehicle is owned or leased by the employer and is provided to one or more employees for use in connection with the employer's trade or business and is used in the employer's trade or business;

(ii) For bona fide noncompensatory business reasons, the employer requires the employee to commute to and/or from work in the vehicle;

(iii) The employer has established a written policy under which neither the employee, nor any individual whose use would be taxable to the employee, may use the vehicle for personal purposes, other than for commuting or de minimis personal use (such as a stop for a personal errand on the way between a business delivery and the employee's home);

(iv) Except for de minimis personal use, the employee does not use the vehicle for any personal purpose other than commuting; and

(v) The employee required to use the vehicle for commuting is not a control employee of the employer (as defined in paragraphs (f) (5) and (6) of this section).

Personal use of a vehicle is all use of the vehicle by an employee that is not used in the employee's trade or business of being an employee of the employer. An employer-provided vehicle that is generally used each workday to transport at least three employees of the employer to and from work in an employer-sponsored commuting vehicle pool is deemed to meet the requirements of paragraphs (f)(1) (i) and (ii) of this section.

(2) *Special rules.* Notwithstanding anything in paragraph (f)(1) of this section to the contrary, the following special rules apply—

(i) *Chauffeur-driven vehicles.* If a vehicle is chauffeur-driven, the commuting valuation rule of this paragraph (f) may not be used to value the commuting use of any person (other than the chauffeur) who rides in the vehicle. (See paragraphs (d) and (e) of this section for other vehicle special valuation rules.) The special rule of this paragraph (f) may be used to value the commuting-only use of the vehicle by the chauffeur if the conditions of paragraph (f)(1) of this section are satisfied. For purposes of this paragraph (f)(2), an individual will not be considered a chauffeur if he or she performs non-driving services for the employer, is not available to perform driving services while performing such other services and whose only driving services consist of driving a vehicle used for commuting by other employees of the employer.

(ii) *Control employee exception.* If the vehicle in which the employee is required to commute is not an automobile as defined in paragraph (d)(1)(ii) of this section, the restriction of paragraph (f)(1)(v) of this section (relating to control employees) does not apply.

(3) *Commuting value*—(i) *$1.50 per one-way commute.* If the requirements of this paragraph (f) are satisfied, the value of the commuting use of an employer-provided vehicle is $1.50 per one-way commute (e.g., from home to work or from work to home). The value provided in this paragraph (f)(3) includes the value of any goods or services directly related to the vehicle (e.g., fuel).

(ii) *Value per employee.* If there is more than one employee who commutes in the vehicle, such as in the case of an employer-sponsored commuting vehicle pool, the amount includible in the income of each employee is $1.50 per one-way commute. Thus, the amount includible for each round-trip commute is $3.00 per employee. See paragraphs (d)(7)(vi) and (e)(5)(vi) of this section for use of the automobile lease valuation and vehicle cents-per-mile valuation special rules for valuing the use or availability of the vehicle in the case of an employer-sponsored vehicle or automobile commuting pool.

(4) *Definition of vehicle.* For purposes of this paragraph (f), the term "vehicle" means any motorized wheeled vehicle manufactured primarily for use on public streets, roads, and highways. The term "vehicle" includes an automobile as defined in paragraph (d)(1)(ii) of this section.

(5) *Control employee defined—Non-government employer.* For purposes of this paragraph (f), a control employee of a non-government employer is any employee—

(i) Who is a Board- or shareholder-appointed, confirmed, or elected officer of the employer whose compensation equals or exceeds $50,000,

(ii) Who is a director of the employer,

(iii) Whose compensation equals or exceeds $100,000, or

(iv) Who owns a one-percent or greater equity, capital, or profits interest in the employer.

For purposes of determining who is a one-percent owner under paragraph (f)(5)(iv) of this section, any individual who owns (or is considered as owning under section 318(a) or principles similar to section 318(a) for entities other than corporations) one percent or more of the fair market value of an entity (the "owned entity") is considered a one-percent owner of all entities which would be aggregated with the owned entity under the rules of section 414(b), (c), (m), or (o). For purposes of determining who is an officer or director with respect to an employer under this paragraph (f)(5), notwithstanding anything in this section to the contrary, if an entity would be aggregated with other entities under the rules of section 414 (b), (c), (m), or (o), the officer definition (but not the compensation requirement) and the director definition apply to each such separate entity rather tha to the aggregated employer. An employee who is an officer or a director of an entity (the "first entity") shall be treated as an officer or a director of all entities aggregated with the first entity under the rules of section 414 (b), (c), (m), or (o). Instead of applying the control employee definition of this paragraph (f)(5), an employer may treat all, and only, employees who are "highly compensated" employees (as defined in § 1.132–8(g)) as control employees for purposes of this paragraph (f).

(6) *Control employee defined—Government employer.* For purposes of this paragraph (f), a control employee of a government employer is any—

(i) Elected official, or

(ii) Employee whose compensation equals or exceeds the compensation paid to a Federal Government employee holding a position at Executive Level V, determined under Chapter 11 of title 2, United States Code, as adjusted by section 5318 of Title 5 United States Code.

For purposes of this paragraph (f), the term "government" includes any Federal, state or local governmental unit, and any agency or instrumentality thereof. Instead of applying the control employee definition of paragraph (f)(6), an employer may treat all and only employees who are "highly compensated" employees (as defined in § 1.132–8(f)) as control employees for purposes of this paragraph (f).

(7) *"Compensation" defined.* For purposes of this paragraph (f), the term "compensation" has the same meaning as in section 414(q)(7). Compensation includes all amounts received from all entities treated as a single employer under section 414 (b), (c) (m), or (o). Levels of compensation shall be adjusted at the sam time and in the same manner as provided in section 415(d). The first such adjustment shall be for calendar year 1988.

(g) *Non-commercial flight valuation rule*—(1) *In general.* Under the non-commercial flight valuation rule of this paragraph (g), except as provided in paragraph (g)(12) of this section, if an employee is provided with a flight on an employer-provided aircraft, the value of the flight is calculated using the aircraft valuation formula of paragraph (g)(5) of this section. For purposes of this paragraph (g), the value of a flight on an employer-provided aircraft by an individual who is less than two years old is deemed to be zero. See paragraph (b)(1) of this section for rules relating to the amount includible in income when an employee reimburses the employee's employer for all or part of the fair market value of the benefit provided.

(2) *Eligible flights and eligible aircraft.* The valuation rule of this paragraph (g) may be used to value flights on all employer-provided aircraft, including helicopters. The valuation rule of this paragraph (g) may be used to value international as well as domestic flights. The valuation rule of this paragraph (g) may not be used to value a flight on any commercial aircraft on which air transportation is sold to the public on a per-seat basis. For a special valuation rule relating to certain flights on commercial aircraft, see paragraph (h) of this section.

(3) *Definition of a flight*—(i) *General rule.* Except as otherwise provided in paragraph (g)(3)(iii) of this section (relating to intermediate stops), for purposes of this paragraph (g), a flight is the distance (in statute miles, i.e., 5,280 feet per statute mile) between the place at which the individual boards the aircraft and the place at which the individual deplanes.

(ii) *Valuation of each flight.* Under the valuation rule of this paragraph (g), value is determined separately for each flight. Thus, a round-trip is comprised of at least two flights. For example, an employee who takes a personal trip on an employer-provided aircraft from New York City to Denver, then Denver to Los Angeles, and finally Los Angeles to New York City has taken three flights and must apply the aircraft valuation formula separately to each flight. The value of a flight must be determined on a passenger-by-passenger basis. For example, if an individual accompanies an employee and the flight taken by the individual would be taxed to the employee, the employee would be taxed on the special rule value of the flight by the employee and the flight by the individual.

(iii) *Intermediate stop.* If a landing is necessitated by weather conditions, by an emergency, for purposes of refueling or obtaining other services relating to the aircraft or for any other purpose unrelated to the personal purposes of the employee whose flight is being valued, that landing is an intermediate stop. Additional mileage attributable to an intermediate stop is not considered when determining the distance of an employee's flight.

(iv) *Examples.* The rules of paragraph (g)(3)(iii) of this section may be illustrated by the following examples:

Example (1). Assume that an employee's trip originates in St. Louis, Missouri, with Seattle, Washington as its destination, but, because of weather conditions, the aircraft lands in Denver, Colorado, and the employee stays in Denver overnight. Assume further that the next day the aircraft flies to Seattle where the employee deplanes. The employee's flight is the distance between the airport in St. Louis and the airport in Seattle.

Example (2). Assume that a trip originates in New York, New York, with five passengers and that the aircraft makes a stop in Chicago, Illinois, so that one of the passengers can deplane for a purpose unrelated to the personal purposes of the other passengers whose flights are being valued. The aircraft then goes on to Los Angeles, California, where the other four passengers will deplane. The flight of the passenger who deplaned in Chicago is the distance between the airport in New York and the airport in Chicago. The stop in Chicago is disregarded as an intermediate stop, however, when measuring the flights taken by each of the other four passengers. Their flights would be the distance between the airport in New York and the airport in Los Angeles.

(4) *Personal and non-personal flights*—(i) In *general.* The valuation rule

of this paragraph (g) applies to personal flights on employer-provided aircraft. A personal flight is one the value of which is not excludable under another section of subtitle A of the Internal Revenue Code of 1986, such as under section 132(d) (relating to a working condition fringe). However, solely for purposes of paragraphs (g)(4)(ii) and (g)(4)(iii) of this section, references to personal flights do not include flights a portion of which would not be excludable from income by reason of section 274(c).

(ii) *Trip primarily for employer's business.* If an employee combines, in one trip, personal and business flights on an employer-provided aircraft and the employee's trip is primarily for the employer's business (see § 1.162–2(b)(2)), the employee must include in income the excess of the value of all the flights that comprise the trip over the value of the flights that would have been taken had there been no personal flights but only business flights. For example, assume that an employee flies on an employer-provided aircraft from Chicago, Illinois, to Miami, Florida, for the employer's business and that from Miami the employee flies on the employer-provided aircraft to Orlando, Florida, for personal purposes and then flies back to Chicago. Assume further that the primary purpose of the trip is for the employer's business. The amount includible in income is the excess of the value of the three flights (Chicago to Miami, Miami to Orlando, and Orlando to Chicago), over the value of the flights that would have been taken had there been no personal flights but only business flights (Chicago to Miami and Miami to Chicago).

(iii) *Primarily personal trip.* If an employee combines, in one trip, personal and business flights on an employer-provided aircraft and the employee's trip is primarily personal (see § 1.162–2(b)(2)), the amount includible in the employee's income is the value of the personal flights that would have been taken had there been no business flights but only personal flights. For example, assume that an employee flies on an employer-provided aircraft from San Francisco, California, to Los Angeles, California, for the employer's business and that from Los Angeles the employee flies on an employer-provided aircraft to Palm Springs, California, primarily for personal reasons and then flies back to San Francisco. Assume further that the primary purpose of the trip is personal. The amount includible in the employee's income is the value of personal flights that would have been taken had there been no business flights but only personal flights (San Francisco to Palm Springs and Palm Springs to San Francisco).

(iv) *Application of section 274(c).* The value of employer- provided travel outside the United States away from home may not be excluded from the employee's gross income as a working condition fringe, by either the employer or the employee, to the extent not deductible by reason of section 274(c). The valuation rule of this paragraph (g) applies to that portion of the value any flight not excludable by reason of section 274(c). Such value is includible in income in addition to the amounts determined under paragraphs (g)(4)(ii) and (g)(4)(iii) of this section.

(v) *Flights by individuals who are not personal guests.* If an individual who is not an employee of the employer providing the aircraft is on a flight, and the individual is not the personal guest of any employee of the employer, the flight by the individual is not taxable to any employee of the employer providing the aircraft. The rule in the preceding sentence applies where the individual is provided the flight by the employer for noncompensatory business reasons of the employer. For example, assume that G, an employee of company Y, accompanies A, an employee of company X, on company X's aircraft for the purpose of inspecting land under consideration for purchase by company X from company Y. The flight by G is not taxable to A. No inference may be drawn from this paragraph (g)(4)(v) concerning the taxation of a flight provided to an individual who is neither an employee of the employer nor a personal guest of any employee of the employer.

(5) *Aircraft valuation formula.* Under the valuation rule of this paragraph (g), the value of a flight is determined under the base aircraft valuation formula (also known as the Standard Industry Fare Level formula or SIFL) by multiplying the SIFL cents-per-mile rates applicable for the period during which the flight was taken by the appropriate aircraft multiple (as provided in paragraph (g)(7) of this section) and then adding the applicable terminal charge. The SIFL cents-per-mile rates in the formula and the terminal charge are calculated by the Department of Transportation and are revised semi-annually. The base aircraft valuation formula in effect from January 1, 1989 through June 30, 1989, is as follows: a terminal charge of $26.48 plus ($.1449 per mile for the first 500 miles, $.1105 per mile for miles between 501 and 1500, and $.1062 per mile for miles over 1500). For example, if a flight taken on January 15, 1989, by a non-control employee on an employer-provided aircraft with a maximum certified takeoff weight of 26,000 lbs. is 2,000 miles long, the value of the flight determined under this paragraph (g)(5) is: $100.36 {(.313×{($.1449×500)+($.1105×1,000)+ ($.1062×500)})+$26.48}. The aircraft valuation formula applies separately to each flight being valued under this paragraph (g). Therefore, the number of miles an employee has flown on employer-provided aircraft flights prior to the flight being valued does not affect the determination of the value of the flight.

(6) *Discretion to provide new formula.* The Commissioner may prescribe a different base aircraft valuation formula by regulation, Revenue Ruling or Revenue Procedure in the event that the calculation of the Standard Industry Fare Level is discontinued.

(7) *Aircraft multiples*—(i) *In general.* The aircraft multiples are based on the maximum certified takeoff weight of the aircraft. When applying the aircraft valuation formula to a flight, the appropriate aircraft multiple is multiplied by the product of the applicable SIFL cents-per-mile rates multiplied by the number of miles in the flight and then the terminal charge is added to the product. For purposes of applying the aircraft valuation formula described in paragraph (g)(5) of this section, the aircraft multiples are as follows:

Maximum certified take-off weight of the aircraft	Aircraft multiple for a control employee (percent)	Aircraft multiple for a non-control employee (percent)
6,000 lbs. or less	62.5	15.6
6,001–10,000 lbs.	125	23.4
10,001–25,000 lbs.	300	31.3
25,001 lbs. or more	400	31.3

(ii) *Flights treated as provided to a control employee.* Except as provided in paragraph (g)(12) of this section, any flight provided to an individual whose flight would be taxable to a control employee (as defined in paragraphs (g)(8) and (9) of this section) as the recipient shall be valued as if such flight had been provided to that control employee. For example, assume that the chief executive officer of an employer, his spouse, and his two children fly on an employer-provided aircraft for personal purposes. Assume further that the maximum certified takeoff weight of the aircraft is 12,000 lbs. The amount includible in the employee's income is 4×{(300 percent×the applicable SIFL cents-per-mile rates provided in

paragraph (g)(5) of this section multiplied by the number of miles in the flight) plus the applicable terminal charge).

(8) *Control employee defined—Non-government employer*—(i) *Definition.* For purposes of this paragraph (g), a control employee of a non-government employer is any employee—

(*A*) Who is a Board- or shareholder-appointed, confirmed, or elected officer of the employer, limited to the lesser of—

(*1*) One percent of all employees (increased to the next highest integer, if not an integer) or

(*2*) Ten employees;

(B) Who is among the top one percent most highly-paid employees of the employer (increased to the next highest integer, if not an integer) limited to a maximum of 50;

(C) Who owns a five-percent or greater equity, capital, or profits interest in the employer; or

(D) Who is a director of the employer.

(ii) *Special rules for control employee definition*—(A) *In general.* For purposes of this paragraph (g), any employee who is a family member (within the meaning of section 267(c)(4)) of a control employee is also a control employee. For purposes of paragraph (g)(8)(i)(B) of this section, the term "employee" does not include any individual unless such individual is a common-law employee, partner, or one-percent or greater shareholder of the employer. Pursuant to this paragraph (g)(8), an employee may be a control employee under more than one of the requirements listed in paragraphs (g)(8)(i) (A) through (D) of this section. For example, an employee may be both an officer under paragraph (g)(8)(i)(A) of this section and a highly-paid employee under paragraph (g)(8)(i)(B) of this section. In this case, for purposes of the officer limitation rule of paragraph (g)(8)(i)(A) of this section and the highly-paid employee limitation rule of paragraph (g)(8)(i)(B) of this section, the employee would be counted in applying both limitations. For purposes of determining the one-percent limitation under paragraphs (g)(8)(i) (A) and (B) of this section, an employer shall exclude from consideration employees described in § 1.132–8(b)(3). Instead of applying the control employee definition of this paragraph (g)(8), an employer may treat all (and only) employees who are "highly compensated" employees (as defined in § 1.132–8(f)) as control employees for purposes of this paragraph (g).

(B) *Special rules for officers, owners, and highly-paid control employees.* In no event shall an employee whose compensation is less than $50,000 be a control employee under paragraph (g)(8)(i) (A) or (B) of this section. For purposes of determining who is a five-percent (or one-percent) owner under this paragraph (g)(8), any individual who owns (or is considered as owning under section 318(a) or principles similar to section 318(a) for entities other than corporations) five percent (or one-percent) or more of the fair market value of an entity (the "owned entity") is considered a five-percent (or one-percent) owner of all entities which would be aggregated with the owned entity under the rules of section 414(b), (c), (m), or (o). For purposes of determining who is an officer or director with respect to an employer under this paragraph (g)(8), notwithstanding anything in this section to the contrary, if the employer would be aggregated with other employers under the rules of section 414 (b), (c), (m), or (o), the officer definition and the limitations and the director definition are applied to each such separate employer rather than to the aggregated employer. An employee who is an officer or director of one employer (the "first employer") shall not be counted as an officer or a director of any other employer aggregated with the first employer under the rules of section 414 (b), (c), or (m). If applicable, the officer limitations rule of paragraph (g)(8)(i)(A) of this section is applied to employees in descending order of their compensation. Thus, if an employer has 11 board-appointed officers and the limit imposed under paragraph (g)(8)(i)(A) of this section is 10 officers, the employee with the least compensation of those officers would not be a control employee under paragraph (g)(8)(i)(A) of this section.

(9) *Control employee defined—Government employer.* For purposes of this paragraph (g), a control employee of a government employer is any—

(i) Elected official, or

(ii) Employee whose compensation equals or exceeds the compensation paid to a Federal Government employee holding a position at Executive Level V, determined under Chapter 11 of title 2, United States Code, as adjusted by section 5318 of title 5 United States Code.

For purposes of paragraph (f), the term "government" includes any Federal, state or local governmental unit, and any agency or instrumentality thereof. Instead of applying the control employee definition of paragraph (f)(6), an employer may treat all and only employees who are "highly compensated" employees (as defined in § 1.132–8(f)) as control employees for purposes of this paragraph (f).

(10) *"Compensation" defined.* For purposes of this paragraph (g), the term "compensation" has the same meaning as in section 414(q)(7). Compensation includes all amounts received from all entities treated as a single employer under section 414 (b), (c), (m), or (o). Levels of compensation shall be adjusted at the same time and in the same manner as provided in section 415(d). The first such adjustment was for calendar year 1988.

(11) *Treatment of former employees.* For purposes of this paragraph (g), an employee who was a control employee of the employer (as defined in this paragraph (g)) at any time after reaching age 55, or within three years of separation from the service of the employer, is a control employee with respect to flights taken after separation from the service of the employer. An individual who is treated as a control employee under this paragraph (g)(11) is not counted when determining the limitation of paragraph (g)(8)(i) (A) and (B) of this section. Thus, the total number of individuals treated as control employees under such paragraphs may exceed the limitations of such paragraphs to the extent that this paragraph (g)(11) applies.

(12) *Seating capacity rule*—(i) *In general*—(A) *General rule.* Where 50 percent or more of the regular passenger seating capacity of an aircraft (as used by the employer) is occupied by individuals whose flights are primarily for the employer's business (and whose flights are excludable from income under section 132(d)), the value of a flight on that aircraft by any employee who is not flying primarily for the employer's business (or who is flying primarily for the employer's business but the value of whose flight is not excludable under section 132(d) by reason of section 274(c)) is deemed to be zero. See § 1.132–5 which limits the working condition fringe exclusion under section 132(d) to situations where the employee receives the flight in connection with the performance of services for the employer providing the aircraft.

(B) *Special rules*—(*1*) *Definition of "employee."* For purposes of this paragraph (g)(12), the term "employee" includes only employees of the employer, including a partner of a partnership, providing the aircraft and does not include independent contractors and directors of the employer. A flight taken by an individual other than an "employee" as defined in the preceding sentence is considered a flight taken by an employee for purposes of this paragraph

(g)(12) only if that individual is treated as an employee pursuant to section 132(f)(1) or that individual's flight is treated as a flight taken by an employee pursuant to section 132(f)(2). If—

(*i*) A flight by an individual is not considered a flight taken by an employee (as defined in this paragraph (g)(12)(i)),

(*ii*) The value of that individual's flight is not excludable under section 132(d), and

(*iii*) The seating capacity rule of this paragraph (g) (12) otherwise applies, then the value of the flight provided to such an individual is the value of a flight provided to a non-control employee pursuant to paragraph (g)(5) of this section (even if the individual who would be taxed on the value of the flight is a control employee).

(*2*) *Example.* The special rules of paragraph (g)(12)(i)(B)(*1*) of this section are illustrated by the following example:

Example. Assume that 60 percent of the regular passenger seating capacity of an employer's aircraft is occupied by individuals whose flights are primarily for the employer's business and are excludable from income under section 132(d). If a control employee, his spouse, and his dependent child fly on the employer's aircraft for primarily personal reasons, the value of the three flights is deemed to be zero. If, however, the control employee's cousin were provided a flight on the employer's aircraft, the value of the flight taken by the cousin is determined by applying the aircraft valuation formula of paragraph (g)(5) of this section (including the terminal charge) and the non-control employee aircraft multiples of paragraph (g)(7) of this section.

(ii) *Application of 50-percent test to multiple flights.* The seating capacity rule of this paragraph (g)(12) must be met both at the time the individual whose flight is being valued boards the aircraft and at the time the individual deplanes. For example, assume that employee A boards an employer-provided aircraft for personal purposes in New York, New York, and that at that time 80 percent of the regular passenger seating capacity of the aircraft is occupied by individuals whose flights are primarily for the employer's business (and whose flights are excludable from income under section 132(d)) ("the business passengers"). If the aircraft flies directly to Hartford, Connecticut where all of the passengers, including A, deplane, the requirements of the seating capacity rule of this paragraph (g)(12) have been satisfied. If instead, some of the passengers, including A, remain on the aircraft in Hartford and the aircraft continues on to Boston, Massachusetts, where they all deplane, the requirements of the seating capacity rule of this paragraph (g)(12) will not be satisfied with respect to A's flight from New York to Boston unless at least 50 percent of the seats comprising the aircraft's regular passenger seating capacity were occupied by the business passengers at the time A deplanes in Boston.

(iii) *Regular passenger seating capacity.* (A) *General rule.* Except as otherwise provided, the regular passenger seating capacity of an aircraft is the maximum number of seats that have at any time on or prior to the date of the flight been on the aircraft (while owned or leased by the employer). Except to the extent excluded pursuant to paragraph (g)(12)(v) of this section, regular seating capacity includes all seats which may be occupied by members of the flight crew. It is irrelevant that, on a particular flight, less than the maximum number of seats are available for use because, for example, some of the seats are removed.

(B) *Special rules.* When determining the maximum number of seats that have at any time on or prior to the date of the flight been on the aircraft (while owned or leased by the employer), seats that could not at any time be legally used during takeoff and have not at any time been used during takeoff are not counted. As of the date an employer permanently reduces the seating capacity of an aircraft, the regular passenger seating capacity is the reduced number of seats on the aircraft. The previous sentence shall not apply if at any time within 24 months after such reduction any seats are added in the aircraft. Unless the conditions of this paragraph (g)(12)(iii)(B) are satisfied, jumpseats and removable seats used solely for purposes of flight crew training are counted for purposes of the seating capacity rule of this paragraph (g)(12).

(iv) *Examples.* The rules of paragraph (g)(12)(iii) of this section are illustrated by the following examples:

Example (1). Employer A and employer B order the same aircraft, except that A orders it with 10 seats and B orders it with eight seats. A always uses its aircraft as a 10-seat aircraft; B always uses its aircraft as an eight-seat aircraft. The regular passenger seating capacity of A's aircraft is 10 and of B's aircraft is eight.

Example (2). Assume the same facts as in example (1), except that whenever A's chief executive officer and spouse use the aircraft eight seats are removed. Even if substantially all of the use of the aircraft is by the chief executive officer and spouse, the regular passenger seating capacity of the aircraft is 10.

Example (3). Assume the same facts as in example (1), except that whenever more than eight people want to fly in B's aircraft, two extra seats are added. Even if substantially all of the use of the aircraft occurs with eight seats, the regular passenger seating capacity of the aircraft is 10.

Example (4). Employer C purchases an aircraft with 12 seats. Three months later C remodels the interior of the aircraft and permanently removes four of the seats. Upon completion of the remodeling, the regular passenger seating capacity of the aircraft is eight. If, however, any seats are added within 24 months after the remodeling, the regular seating capacity of the aircraft is treated as 12 throughout the entire period.

(v) *Seats occupied by flight crew.* When determining the regular passenger seating capacity of an aircraft, any seat occupied by a member of the flight crew (whether or not such individual is an employee of the employer providing the aircraft) shall not be counted, unless the purpose of the flight by such individual is not primarily to serve as a member of the flight crew. If the seat occupied by a member of the flight crew is not counted as a passenger seat pursuant to the previous sentence, such member of the flight crew is disregarded in applying the 50-percent test described in the first sentence of paragraph (g)(12)(i) of this section. For example, assume that prior to application of this paragraph (g)(12)(v) the regular passenger seating capacity of an aircraft is one. Assume further that an employee pilots the aircraft and that the employee's flight is nor primarily for the employer's business. If the employee's spouse occupies the other seat for personal purposes, the seating capacity rule is not met and the value of both flights must be included in the employee's income. If, however, the employee's flight were primarily for the employer's business (unrelated to serving as a member of the flight crew), then the seating capacity rule is met and the value of the flight for the employee's spouse is deemed to be zero. If the employee's flight were primarily to serve as a member of the flight crew, then the seating capacity rule is not met and the value of a flight by any passenger for primarily personal reasons is not deemed to be zero.

(13) *Erroneous use of the non-commercial flight valuation rule*—(i) *Certain errors in the case of a flight by a control employee.* If—

(A) The non-commercial flight valuation rule of this paragraph (g) is applied by an employer or a control employee, as the case may be, on a return as originally filed or on an amended return on the grounds that either—

(*1*) The control employee is not in fact a control employee, or

(*2*) The aircraft is within a specific weight classification, and

(B) Either position is subsequently determined to be erroneous, the valuation rule of this paragraph (g) is not available to value the flight taken by that control employee by the person or persons taking the erroneous position. With respect to the weight classifications, the previous sentence does not apply if the position taken is that the weight of the aircraft is greater than it is subsequently determined to be. If, with respect to a flight by a control employee, the seating capacity rule of paragraph (g)(12) of this section is used by an employer or the control employee, as the case may be, on a return as originally filed or on an amended return, the valuation rule of this paragraph (g) is not available to value the flight taken by that control employee by the person or persons taking the erroneous position.

(ii) *Value of flight excluded as a working condition fringe.* If either an employer or an employee, on a return as originally filed or on an amended return, excludes from the employee's income or wages all or any part of the value of a flight on the grounds that the flight was excludable as a working condition fringe under section 132, and that position is subsequently determined to be erroneous, the valuation rule of this paragraph (g) is not available to value the flight taken by that employee by the person or persons taking the erroneous position. Instead, the general valuation rules of paragraph (b) (5) and (6) of this section apply.

(14) *Consistency rules*—(i) *Use by the employer.* Except as otherwise provided in paragraph (g)(13) of this section or § 1.132–5 (m)(4), if the non-commercial flight valuation rule of this paragraph (g) is used by an employer to value any flight provided to an employee in a calendar year, the rule must be used to value all flights provided to all employees in the calendar year.

(ii) *Use by the employee.* Except as otherwise provided in paragraph (g)(13) of this section or § 1.132–5 (m)(4), if the non-commercial flight valuation rule of this paragraph (g) is used by an employee to value a flight provided by an employer in a calendar year, the rule must be used to value all flights provided to the employee by that employer in the calendar year.

(h) *Commercial flight valuation rule*—(1) *In general.* Under the commercial flight valuation rule of this paragraph (h), the value of a space-available flight (as defined in paragraph (h) (2) of this section) on a commercial aircraft is 25 percent of the actual carrier's highest unrestricted coach fare in effect for the particular flight taken. The rule of this paragraph (h) is available only to an individual described in § 1.132–1(b)(1).

(2) *Space-available flight.* The commercial flight valuation rule of this paragraph (h) is available to value a space-available flight. The term "space-available flight" means a flight on a commercial aircraft—

(i) Which is subject to the same types of restrictions customarily associated with flying on an employee "stand-by" or "space-available" basis, and

(ii) Which meets the definition of a no-additional-cost service under section 132(b), except that the flight is provided to an individual other than the employee or an individual treated as the employee under section 132(f). Thus, a flight is not a space-available flight if the employer guarantees the employee a seat on the flight or if the nondiscrimination requirements of section 132(h)(1) and § 1.132–8 are not satisfied. A flight may be a space-available flight even if the airline that is the actual carrier is not the employer of the employee.

(3) *Commercial aircraft.* If the actual carrier does not offer, in the ordinary course of its business, air transportation to customers on a per-seat basis, the commercial flight valuation rule of this paragraph (h) is not available. Thus, if, in the ordinary course of its line of business, the employer only offers air transportation to customers on a charter basis, the commercial flight valuation rule of this paragraph (h) may not be used to value a space-available flight on the employer's aircraft. If the commercial flight valuation rule is not available, the flight may be valued under the non-commercial flight valuation rule of paragraph (g) of this section.

(4) *Timing of inclusion.* The date that the flight is taken is the relevant date for purposes of applying section 61(a)(1) and this section to a space-available flight on a commercial aircraft. The date of purchase or issuance of a pass or ticket is not relevant. Thus, this section applies to a flight taken on or after January 1, 1989, regardless of the date on which the pass or ticket for the flight was purchased or issued.

(5) *Consistency rules*—(i) *Use by employer.* If the commercial flight valuation rule of this paragraph (h) is used by an employer to value any flight provided in a calendar year, the rule must be used to value all flights eligible for use of the rule provided in the calendar year.

(ii) *Use by employee.* If the commercial flight valuation rule of this paragraph (h) is used by an employee to value a flight provided by an employer in a calendar year, the rule must be used to value all flights provided by that employer eligible for use of the rule taken by such employee in the calendar year.

(i) [Reserved.]

(j) *Valuation of meals provided at an employer-operated eating facility for employees*—(1) *In general.* The valuation rule of this paragraph (j) may be used to value a meal provided at an employer-operated eating facility for employees (as defined in § 1.132–7). For rules relating to an exclusion for the value of meals provided at an employer-operated eating facility for employees, see section 132(e)(2) and § 1.132–7.

(2) *Valuation formula*—(i) *In general.* The value of all meals provided at an employer-operated eating facility for employees during a calendar year ("total meal value") is 150 percent of the direct operating costs of the eating facility determined separately with respect to such eating facility whether or not the direct operating costs test is applied separately to such eating facility under § 1.132–7(b)(2). For purposes of this paragraph (j), the definition of direct operating costs provided in § 1.132–7(b) and the adjustments specified in § 1.132–7(a)(2) apply. The taxable value of meals provided at an eating facility may be determined in two ways. The "individual meal subsidy" may be treated as the taxable value of a meal provided at the eating facility (see paragraph (j)(2)(ii) of this section) to a particular employee. Alternatively, the employer may allocate the "total meal subsidy" among employees (see paragraph (j)(2)(iii) of this section).

(ii) *"Individual meal subsidy" defined.* The "individual meal subsidy" is determined by multiplying the amount paid by the employee for a particular meal by a fraction, the numerator of which is the total meal value and the denominator of which is the gross receipts of the eating facility for the calendar year and then subtracting the amount paid by the employee for the meal. The taxable value of meals provided to a particular employee during a calendar year, therefore, is the sum of the individual meal subsidies provided to the employee during the calendar year. This rule is available only if there is a charge for each meal selection and if each employee is charged the same price for any given meal selection.

(iii) *Allocation of "total meal subsidy."* Instead of using the individual meal subsidy method provided in paragraph (j)(2)(ii) of this section, the employer may allocate the "total meal subsidy" (total meal value less the gross receipts of the facility) among employees in any manner reasonable under the circumstances. It will be

presumed reasonable for an employer to allocate the total meal subsidy on a per-employee basis if the employer has information that would substantiate to the satisfaction of the Commissioner that each employee was provided approximately the same number of meals at the facility.

§§ 1.132-1T, 1.132-2T, 1.132-3T, 1.132-4T, 1.132-5T, 1.132-6T, 1.132-7T and 1.132-8T [Amended]

Par. 6. Sections 1.132-1T, 1.132.2T, 1.132-3T, 1.132-4T, 1.1325T, 1.132-6T, 1.132-7T and 1.132-8T are amended by revising the titles of such sections to read as follows:

§ 1.132-1T Exclusion from gross income of certain fringe benefits—1985 through 1988 (Temporary).

§ 1.132-2T No-additional-cost service—1985 through 1988 (Temporary).

§ 1.132-3T Qualified employee discount—1985 through 1988 (Temporary).

§ 1.132-4T Line of business limitation—1985 through 1988 (Temporary).

§ 1.132-5T Working condition fringe—1985 through 1988 (Temporary).

§ 1.132-6T De minimis fringe—1985 through 1988 (Temporary).

§ 1.132-7T Treatment of employer-operated eating facilities—1985 through 1988 (Temporary).

§ 1.132-8T Nondiscrimination rules—1985 through 1988 (Temporary).

Par. 7. Section 1.132-0 is added and reads as follows:

§ 1.132-0 Outline of regulations under section 132.

The following is an outline of regulations in this section relating to exclusions from gross income for certain fringe benefits:

Par. 8. Section 1.132–1 is added and reads as follows:

§ 1.132–1 Exclusion from gross income for certain fringe benefits.

(a) *In general.* Gross income does not include any fringe benefit which qualifies as a—

(1) No-additional-cost service.

(2) Qualified employee discount,

(3) Working condition fringe, or

(4) De minimis fringe.

Special rules apply with respect to certain on-premises gyms and other athletic facilities (§ 1.132–1(e)), demonstration use of employer-provided automobiles by full-time automobile salesmen (§ 1.132–5(o)), parking provided to an employee on or near the business premises of the employer (§ 1.132–5(p)), and on-premises eating facilities (§ 1.132–7).

(b) *Definition of employee—(1) No-additional-cost services and qualified employee discounts.* For purposes of section 132(a)(1) (relating to no-additonal-cost services) and section 132(a)(2) (relating to qualified employee discounts), the term "employee" (with respect to a line of business of an employer means—

(i) Any individual who is currently employed by the employer in the line of business,

(ii) Any individual who was formerly employed by the employer in the line of business and who separated from service with the employer in the line of business by reason of retirement or disability, and

(iii) Any widow or widower of an individual who died while employed by the employer in the line of business or who separated from service with the employer in the line of business by reason of retirement or disability.

For purposes of this paragraph (b)(1), any partner who performs services for a partnership is considered employed by the partnership. In addition, any use by the spouse or dependent child (as defined in paragraph (b)(5) of this section) of the employee will be treated as use by the employee. For purposes of section 132(a)(1) (relating to no-additional-cost services), any use of air transportation by a parent of an employee (determined without regard to section 132(f)(1)(B) and paragraph (b)(1)(iii) of this section) will be treated as use by the employee.

(2) *Working condition fringes.* For purposes of section 132(a)(3) (relating to working condition fringes), the term "employee" means—

(i) Any individual who is currently employed by the employer,

(ii) Any partner who performs services for the partnership,

(iii) Any director of the employer, and

(iv) Any independent contractor who performs services for the employer.

Notwithstanding anything in this paragraph (b)(2) to the contrary, an independent contractor who performs services for the employer cannot exclude the value of parking or the use of consumer goods provided pursuant to a product testing program under § 1.132–5(n); in addition, any director of the employer cannot exclude the value of the use of consumer goods provided pursuant to a product testing program under § 1.132–5(n).

(3) *On-premises athletic facilities.* For purposes of section 132(h)(5) (relating to on-premises athletic facilities), the term "employee" means—

(i) Any individual who is currently employed by the employer,

(ii) Any individual who was formerly employed by the employer and who separated from service with the employer by reason of retirement or disability, and

(iii) Any widow or widower of an individual who died while employed by the employer or who separated from service with the employer by reason of retirement or disability.

For purposes of this paragraph (b)(3), any partner who performs services for a partnership is considered employed by the partnership. In addition, any use by the spouse or dependent child (as defined in paragraph (b)(5) of this section) of the employee will be treated as use by the employee.

(4) *De minimis fringes.* For purposes of section 132(a)(4) (relating to de minimis fringes), the term "employee" means any recipient of a fringe benefit.

(5) *Dependent child.* The term "dependent child" means any son, stepson, daughter, or stepdaughter of the employee who is a dependent of the employee, or both of whose parents are deceased and who has not attained age 25. Any child to whom section 152(e) applies will be treated as the dependent of both parents.

(c) *Special rules for employers—Effect of section 414.* All employees treated as employed by a single employer under section 414 (b), (c), (m), or (o) will be treated as employed by a single employer for purposes of this section. Thus, employees of one corporation that is part of a controlled group of corporations may under certain circumstances be eligible to receive section 132 benefits from the other corporations that comprise the controlled group. However, the aggregation of employers described in this paragraph (c) does not change the other requirements for an exclusion, such as the line of business requirement. Thus, for example, if a controlled group of corporations consists of two corporations that operate in different lines of business, the corporations are not treated as operating in the same line of business even though the corporations are treated as one employer.

(d) *Customers not to include employees.* For purposes of section 132 and the regulations thereunder, the term

"customer" means any customer who is not an employee. However, the preceding sentence does not apply to section 132(c)(2) (relating to the gross profit percentage for determining a qualified employee discount). Thus, an employer that provides employee discounts cannot exclude sales made to employees in determining the aggregate sales to customers.

(e) *Treatment of on-premises athletic facilities—(1) In general.* Gross income does not include the value of any on-premises athletic facility provided by an employer to its employees. For purposes of section 132(h)(5) and this paragraph (e), the term "on-premises athletic facility" means any gym or other athletic facility (such as a pool, tennis court, or golf course)—

(i) Which is located on the premises of the employer, (ii) Which is operated by the employer, and (iii) Substantially all of the use of which during the calendar year is by employees of the employer, their spouses, and their dependent children.

For purposes of paragraph (e) (1) (iii) of this section, the term "dependent children" has the same meaning as the plural of the term "dependent child" in paragraph (b)(5) of this section. The exclusion of this paragraph (e) does not apply to any athletic facility if access to the facility is made available to the general public through the sale of memberships, the rental of the facility, or a similar arrangement.

(2) *Premises of the employer.* The athletic facility need not be located on the employer's business premises. However, the athletic facility must be located on premises of the employer. The exclusion provided in this paragraph (e) applies whether the premises are owned or leased by the employer; in addition, the exclusion is available even if the employer is not a named lessee on the lease so long as the employer pays reasonable rent. The exclusion provided in this paragraph (e) does not apply to any athletic facility that is a facility for residential use. Thus, for example, a resort with accompanying athletic facilities (such as tennis courts, pool, and gym) would not qualify for the exclusion provided in this paragraph (e). An athletic facility is considered to be located on the employer's premises if the facility is located on the premises of a voluntary employees' beneficiary association funded by the employer.

(3) *Application of rules to membership in an athletic facility.* The exclusion provided in this paragraph (e) does not apply to any membership in an athletic facility (including health clubs or country clubs) unless the facility is owned (or leased) and operated by the employer and substantially all the use of the facility is by employees of the employer, their spouses, and their dependent children. Therefore, membership in a health club or country club not meeting the rules provided in this paragraph (e) would not qualify for the exclusion.

(4) *Operation by the employer.* An employer is considered to operate the athletic facility if the employer operates the facility through its own employees, or if the employer contracts out to another to operate the athletic facility. For example, if an employer hires an independent contractor to operate the athletic facility for the employer's employees, the facility is considered to be operated by the employer. In addition, if an athletic facility is operated by more than one employer, it is considered to be operated by each employer. For purposes of paragraph (e) (1) (iii) of this section, substantially all of the use of a facility that is operated by more than one employer must be by employees of the various employers, their spouses, and their dependent children. Where the facility is operated by more than one employer, an employer that pays rent either directly to the owner of the premises or to a sublessor of the premises is eligible for the exclusion. If an athletic facility is operated by a voluntary employees' beneficiary association funded by an employer, the employer is considered to operate the facility.

(5) *Nonapplicability of nondiscrimination rules.* The nondiscrimination rules of section 132 and § 1.132–8 do not apply to on-premises athletic facilities.

(f) *Nonapplicability of section 132 in certain cases*—(1) Tax treatment provided for in another section. If the tax treatment or a particular fringe benefit is expressly provided for in another section of Chapter 1 of the Internal Revenue Code of 1986, section 132 and the applicable regulations (except for section 132 (e) and the regulations thereunder) do not apply to such fringe benefit. For example, because section 129 provides an exclusion from gross income for amounts paid or incurred by an employer for dependent care assistance for an employee, the exclusions under section 132 and this section do not apply to the provision by an employer to an employee of dependent care assistance. Similarly, because section 117 (d) applies to tuition reductions, the exclusions under section 132 do not apply to free or discounted tuition provided to an employee by an organization operated by the employer, whether the tuition is for study at or below the graduate level. Of course, if the amounts paid by the employer are for education relating to the employee's trade or business of being an employee of the employer so that, if the employee paid for the education, the amount paid could be deducted under section 162, the costs of the education may be eligible for exclusion as a working condition fringe.

(2) *Limited statutory exclusions.* If another section of Chapter 1 of the Internal Revenue Code of 1986 provides an exclusion from gross income based on the cost of the benefit provided to the employee and such exclusion is a limited amount, section 132 and the regulations thereunder may apply to the extent the cost of the benefit exceeds the statutory exclusion.

(g) *Effective date.* Sections 1.132–0, 1.132–1, 1.132–2, 1,132–3, 1.132–4, 1.132–5, 1.132–6, 1.132–7 and 1.132–8 are effective as of January 1, 1989, except that §§ 1.132–1(b)(1) with respect to the use of air transportation by a parent of an employee and 1.132–4(d) are effective as of January 1, 1985. See §§ 1.132–1T, 1.132–2T, 1.132–3T, 1.132–4T, 1.132–5T, 1.132–6T, 1.132–7T and 1.132–8T for rules in effect for benefits received from January 1, 1985, to December 31, 1988.

Par. 9. Section 1.132–2 is added and reads as follows:

§ 1.132–2 No-additional-cost services.

(a) *In general*—(1) *Definition.* Gross income does not include the value of a no-additional-cost service. A "no-additional-cost service" is any service provided by an employer to an employee for the employee's personal use if—

(i) The service is offered for sale by the employer to its customers in the ordinary course of the line of business of the employer in which the employee performs substantial services, and

(ii) The employer incurs no substantial additional cost in providing the service to the employee (including foregone revenue and excluding any amount paid by or on behalf of the employee for the service).

For rules relating to the line of business limitation, see § 1.132–4. For purposes of this section, a service will not be considered to be offered for sale by the employer to its customers if that service is primarily provided to employees and not to the employer's customers.

(2) *Excess capacity services.* Services that are eligible for treatment as no-additional-cost services include excess capacity services such as hotel accommodations; transportation by

aircraft, train, bus, subway, or cruise line; and telephone services. Services that are not eligible for treatment as no-additional-cost services are non-excess capacity services such as the facilitation by a stock brokerage firm of the purchase of stock. Employees who receive non-excess capacity services may, however, be eligible for a qualified employee discount of up to 20 percent of the value of the service provided. See § 1.132–3.

(3) *Cash rebates.* The exclusion for a no-additional-cost service applies whether the service is provided at no charge or at a reduced price. The exclusion also applies if the benefit is provided through a partial or total cash rebate of an amount paid for the service.

(4) *Applicability of nondiscrimination rules.* The exclusion for a no-additional-cost service applies to highly compensated employees only if the service is available on substantially the same terms to each member of a group of employees that is defined under a reasonable classification set up by the employer that does not discriminate in favor of highly compensated employees. See § 1.132–8.

(5) *No substantial additional cost*—(i) *In general.* The exclusion for a no-additional-cost service applies only if the employer does not incur substantial additional cost in providing the service to the employee. For purposes of the preceding sentence, the term "cost" includes revenue that is forgone because the service is provided to an employee rather than a nonemployee. (For purposes of determining whether any revenue is forgone, it is assumed that the employee would not have purchased the service unless it were available to the employee at the actual price charged to the employee.) Whether an employer incurs substantial additional cost must be determined without regard to any amount paid by the employee for the service. Thus, any reimbursement by the employee for the cost of providing the service does not affect the determination of whether the employer incurs substantial additional cost.

(ii) *Labor intensive services.* An employer must include the cost of labor incurred in providing services to employees when determining whether the employer has incurred substantial additional cost. An employer incurs substantial additional cost, whether non-labor costs are incurred, if a substantial amount of time is spent by the employer or its employees in providing the service to employees. This would be the result whether the time spent by the employer or its employees in providing the services would have been "idle," or if the services were provided outside normal business hours. An employer generally incurs no substantial additional cost, however, if the services provided to the employee are merely incidental to the primary service being provided by the employer. For example, the in-flight services of a flight attendant and the cost of in-flight meals provided to airline employees traveling on a space-available basis are merely incidental to the primary service being provided (i.e., air transportation). Similarly, maid service provided to hotel employees renting hotel rooms on a space-available basis is merely incidental to the primary service being provided (i.e., hotel accommodations).

(6) *Payments for telephone service.* Payment made by an entity subject to the modified final judgment (as defined in section 559(c)(5) of the Tax Reform Act of 1984) of all or part of the cost of local telephone service provided to an employee by a person other than an entity subject to the modified final judgment shall be treated as telephone service provided to the employee by the entity making the payment for purposes of this section. The preceding sentence also applies to a rebate of the amount paid by the employee for the service and a payment to the person providing the service. This paragraph (a)(6) applies only to services and employees described in § 1.132–4 (c). For a special line of business rule relating to such services and employees, see § 1.132–4 (c).

(b) *Reciprocal agreements.* For purposes of the exclusion from gross income for a no-additional-cost service, an exclusion is available to an employee of one employer for a no-additional-cost service provided by an unrelated employer only if all of the following requirements are satisfied—

(1) The service provided to such employee by the unrelated employer is the same type of service generally provided to nonemployee customers by both the line of business in which the employee works and the line of business in which the service is provided to such employee (so that the employee would be permitted to exclude from gross income the value of the service if such service were provided directly by the employee's employer);

(2) Both employers are parties to a written reciprocal agreement under which a group of employees of each employer, all of whom perform substantial services in the same line of business, may receive no-additional-cost services from the other employer; and

(3) Neither employer incurs any substantial additional cost (including forgone revenue) in providing such service to the employees of the other employer, or pursuant to such agreement. If one employer receives a substantial payment from the other employer with respect to the reciprocal agreement, the paying employer will be considered to have incurred a substantial additional cost pursuant to the agreement, and consequently services performed under the reciprocal agreement will not qualify for exclusion as no-additional-cost services.

(c) *Example.* The rules of this section are illustrated by the following example:

Example. Assume that a commercial airline permits its employees to take personal flights on the airline at no charge and receive reserved seating. Because the employer forgoes potential revenue by permitting the employees to reserve seats, employees receiving such free flights are not eligible for the no-additional-cost exclusion.

Par. 10. Section 1.132–3 is added and reads as follows:

§ 1.132–3 Qualified employee discounts.

(a) *In general*—(1) *Definition.* Gross income does not include the value of a qualified employee discount. A "qualified employee discount" is any employee discount with respect to qualified property or services provided by an employer to an employee for use by the employee to the extent the discount does not exceed—

(i) The gross profit percentage multiplied by the price at which the property is offered to customers in the ordinary course of the employer's line of business, for discounts on property, or

(ii) Twenty percent of the price at which the service is offered to customers, for discounts on services.

(2) *Qualified property or services*—(i) *In general.* The term "qualified property or services" means any property or services that are offered for sale to customers in the ordinary course of the line of business of the employer in which the employee performs substantial services. For rules relating to the line of business limitation, see § 1.132–4.

(ii) *Exception for certain property.* The term "qualified property" does not include real property and it does not include personal property (whether tangible or intangible) of a kind commonly held for investment. Thus, an employee may not exclude from gross income the amount of an employee discount provided on the purchase of securities, commodities, or currency, or of either residential or commercial real estate, whether or not the particular purchase is made for investment purposes.

(iii) *Property and services not offered in ordinary course of business.* The term

"qualified property or services" does not include any property or services of a kind that is not offered for sale to customers in the ordinary course of the line of business of the employer. For example, employee discounts provided on property or services that are offered for sale primarily to employees and their families (such as merchandise sold at an employee store or through an employer-provided catalog service) may not be excluded from gross income. For rules relating to employer-operated eating facilities, see § 1.132–7, and for rules relating to employer-operated on-premises athletic facilities, see § 1.132–1(e).

(3) *No reciprocal agreement exception.* The exclusion for a qualified employee discount does not apply to property or services provided by another employer pursuant to a written reciprocal agreement that exists between employers to provide discounts on property and services to employees of the other employer.

(4) *Property or services provided without charge, at a reduced price, or by rebates.* The exclusion for a qualified employee discount applies whether the property or service is provided at no charge (in which case only part of the discount may be excludable as a qualified employee discount) or at a reduced price. The exclusion also applies if the benefit is provided through a partial or total cash rebate of an amount paid for the property or service.

(5) *Property or services provided directly by the employer or indirectly through a third party.* A qualified employee discount may be provided either directly by the employer or indirectly through a third party. For example, an employee of an appliance manufacturer may receive a qualified employee discount on the manufacturer's appliances purchased at a retail store that offers such appliances for sale to customers. The employee may exclude the amount of the qualified employee discount whether the employee is provided the appliance at no charge or purchases it at a reduced price, or whether the employee receives a partial or total cash rebate from either the employer-manufacturer or the retailer. If an employee receives additional rights associated with the property that are not provided by the employee's employer to customers in the ordinary course of the line of business in which the employee performs substantial services (such as the right to return or exchange the property or special warranty rights), the employee may only receive a qualified employee discount with respect to the property and not the additional rights. Receipt of such additional rights may occur, for example, when an employee of a manufacturer purchases property manufactured by the employee's employer at a retail outlet.

(6) *Applicability of nondiscrimination rules.* The exclusion for a qualified employee discount applies to highly compensated employees only if the discount is available on substantially the same terms to each member of a group of employees that is defined under a reasonable classification set up by the employer that does not discriminate in favor of highly compensated employees. See § 1.132–8.

(b) *Employee discount*—(1) *Definition.* The term "employee discount" means the excess of—

(i) The price at which the property or service is being offered by the employer for sale to customers, over

(ii) The price at which the property or service is provided by the employer to an employee for use by the employee. A transfer of property by an employee without consideration is treated as use by the employee for purposes of this section. Thus, for example, if an employee receives a discount on property offered for sale by his employer to customers and the employee makes a gift of the property to his parent, the property will be considered to be provided for use by the employee; thus, the discount will be eligible for exclusion as a qualified employee discount.

(2) *Price to customers*—(i) *Determined at time of sale.* In determining the amount of an employee discount, the price at which the property or service is being offered to customers at the time of the employee's purchase is controlling. For example, assume that an employer offers a product to customers for $20 during the first six months of a calendar year, but at the time the employee purchases the product at a discount, the price at which the product is being offered to customers is $25. In this case, the price from which the employee discount is measured is $25. Assume instead that, at the time the employee purchases the product at a discount, the price at which the product is being offered to customers is $15 and the price charged the employee is $12. The employee discount is measured from $15, the price at which the product is offered for sale to customers at the time of the employee purchase. Thus, the employee discount is $15 − $12, or $3.

(ii) *Quantity discount not reflected.* The price at which a property or service is being offered to customers cannot reflect any quantity discount unless the employee actually purchases the requisite quantity of the property or service.

(iii) *Price to employer's customers controls.* In determining the amount of an employee discount, the price at which a property or service is offered to customers of the employee's employer is controlling. Thus, the price at which the property is sold to the wholesale customers of a manufacturer will generally be lower than the price at which the same property is sold to the customers of a retailer. However, see paragraph (a)(5) of this section regarding the effect of a wholesaler providing to its employees additional rights not provided to customers of the wholesaler in the ordinary course of its business.

(iv) *Discounts to discrete customer or consumer groups.* Subject to paragraph (2)(ii) of this section, if an employer offers for sale property or services at one or more discounted prices to discrete customer or consumer groups, and sales at all such discounted prices comprise at least 35 percent of the employer's gross sales for a representative period, then in determining the amount of an employee discount, the price at which such property or service is being offered to customers for purposes of this section is a discounted price. The applicable discounted price is the current undiscounted price, reduced by the percentage discount at which the greatest percentage of the employer's discounted gross sales are made for such representative period. If sales at different percentage discounts equal the same percentage of the employer's gross sales, the price at which the property or service is being provided to customers may be reduced by the average of the discounts offered to each of the two groups. For purposes of this section, a representative period is the taxable year of the employer immediately preceding the taxable year in which the property or service is provided to the employee at a discount. If more than one employer would be aggregated under section 414 (b), (c), (m), or (o), and not all of the employers have the same taxable year, the employers required to be aggregated must designate the 12-month period to be used in determining gross sales for a representative period. The 12-month period designated, however, must be used on a consistent basis.

(v) *Examples.* The rules provided in this paragraph (b)(2) are illustrated by the following examples:

Example (1). Assume that a wholesale employer offers property for sale to two discrete customer groups at differing prices.

Assume further that during the prior taxable year of the employer, 70 percent of the employer's gross sales are made at a 15 percent discount and 30 percent at no discount. For purposes of this paragraph (b)(2), the current undiscounted price at which the property or service is being offered by the employer for sale to customers may be reduced by the 15 percent discount.

Example (2). Assume that a retail employer offers a 20 percent discount to members of the American Bar Association, a 15 percent discount to members of the American Medical Association, and a ten percent discount to employees of the Federal Government. Assume further that during the prior taxable year of the employer, sales to American Bar Association members equal 15 percent of the employer's gross sales, sales to American Medical Association members equal 20 percent of the employer's gross sales, and sales to Federal Government employees equal 25 percent of the employer's gross sales. For purposes of this paragraph (b)(2), the current undiscounted price at which the property or service is being offered by the employer for sale to customers may be reduced by the ten percent Federal Government discount.

(3) *Damaged, distressed, or returned goods.* If an employee pays at least fair market value for damaged, distressed, or returned property, such employee will not have income attributable to such purchase.

(c) *Gross profit percentage*—(1) *In general*—(i) *General rule.* An exclusion from gross income for an employee discount on qualified property is limited to the price at which the property is being offered to customers in the ordinary course of the employer's line of business, multiplied by the employer's gross profit percentage. The term "gross profit percentage" means the excess of the aggregate sales price of the property sold by the employer to customers (including employees) over the employer's aggregate cost of the property, then divided by the aggregate sales price.

(ii) *Calculation of gross profit percentage.* The gross profit percentage must be calculated separately for each line of business based on the aggregate sales price and aggregate cost of property in that line of business for a representative period. For purposes of this section, a representative period is the taxable year of the employer immediately preceding the taxable year in which the discount is available. For example, if the aggregate amount of sales of property in an employer's line of business for the prior taxable year was $800,000, and the aggregate cost of the property for the year was $600,000, the gross profit percentage would be 25 percent ($800,000 minus $600,000, then divided by $800,000). If two or more employers are required to aggregate under section 414 (b), (c), (m), or (o) (aggregated employer), and if all of the aggregated employers do not share the same taxable year, then the aggregated employers must designate the 12-month period to be used in determining the gross profit percentage. The 12-month period designated, however, must be used on a consistent basis. If an employee performs substantial services in more than one line of business, the gross profit percentage of the line of business in which the property is sold determines the amount of the excludable employee discount.

(iii) *Special rule for employers in their first year of existence.* An employer in its first year of existence may estimate the gross profit percentage of a line of business based on its mark-up from cost. Alternatively, an employer in its first year of existence may determine the gross profit percentage by reference to an appropriate industry average.

(iv) *Redetermination of gross profit percentage.* If substantial changes in an employer's business indicate at any time that it is inappropriate for the prior year's gross profit percentage to be used for the current year, the employer must, within a reasonable period, redetermine the gross profit percentage for the remaining portion of the current year as if such portion of the year were the first year of the employer's existence.

(2) *Line of business.* In general, an employer must determine the gross profit percentage on the basis of all property offered to customers (including employees) in each separate line of business. An employer may instead select a classification of property that is narrower than the applicable line of business. However, the classification must be reasonable. For example, if an employer computes gross profit percentage according to the department in which products are sold, such classification is reasonable. Similarly, it is reasonable to compute gross profit percentage on the basis of the type of merchandise sold (such as high mark-up and low mark-up classifications). It is not reasonable, however, for an employer to classify certain low mark-up products preferred by certain employees (such as highly compensated employees) with high mark-up products or to classify certain high mark-up products preferred by other employees with low mark-up products.

(3) *Generally accepted accounting principles.* In general, the aggregate sales price of property must be determined in accordance with generally accepted accounting principles. An employer must compute the aggregate cost of property in the same manner in which it is computed for the employer's Federal income tax liability; thus, for example, section 263A and the regulations thereunder apply in determining the cost of property.

(d) *Treatment of leased sections of department stores*—(1) *In general*—(i) *General rule.* For purposes of determining whether employees of a leased section of a department store may receive qualified employee discounts at the department store and whether employees of the department store may receive qualified employee discounts at the leased section of the department store, the leased section is treated as part of the line of business of the person operating the department store, and employees of the leased section are treated as employees of the person operating the department store as well as employees of their employer. The term "leased section of a department store" means a section of a department store where substantially all of the gross receipts of the leased section are from over-the-counter sales of property made under a lease, license, or similar arrangement where it appears to the general public that individuals making such sales are employed by the department store. A leased section of a department store which, in connection with the offering of beautician services, customarily makes sales of beauty aids in the ordinary course of business is deemed to derive substantially all of its gross receipts from over-the-counter sales of property.

(ii) *Calculation of gross profit percentage.* For purposes of paragraph (d) of this section, when calculating the gross profit percentage of property and services sold at a department store, sales of property and services sold at the department store, as well as sales of property and services sold at the leased section, are considered. The rule provided in the preceding sentence does not apply, however, if it is more reasonable to calculate the gross profit percentage for the department store and leased section separately, or if it would be inappropriate to combine them (such as where either the department store or the leased section but not both provides employee discounts).

(2) *Employees of the leased section*—(i) *Definition.* For purposes of this paragraph (d), "employees of the leased section" means all employees who perform substantial services at the leased section of the department store regardless of whether the employees engage in over-the-counter sales of property or services. The term "employee" has the same meaning as in section 132(f) and § 1.132-1(b)(1).

(ii) *Discounts offered to either department store employees or employees of the leased section.* If the requirements of this paragraph (d) are satisfied, employees of the leased section may receive qualified employee discounts at the department store whether or not employees of the department store are offered discounts at the leased section. Similarly, employees of the department store may receive a qualified employee discount at the leased section whether or not employees of the leased section are offered discounts at the department store.

(e) *Excess discounts.* Unless excludable under a provision of the Internal Revenue Code of 1986 other than section 132(a)(2), an employee discount provided on property is excludable to the extent of the gross profit percentage multiplied by the price at which the property is being offered for sale to customers. If an employee discount exceeds the gross profit percentage, the excess discount is includible in the employee's income. For example, if the discount on employer-purchased property is 30 percent and the employer's gross profit percentage for the period in the relevant line of business is 25 percent, then 5 percent of the price at which the property is being offered for sale to customers is includible in the empoyee's income. With respect to services, an employee discount of up to 20 percent may be excludable. If an employee discount exceeds 20 percent, the excess discount is includible in the employee's income. For example, assume that a commercial airline provides a pass to each of its employees permitting the employees to obtain a free round-trip coach ticket with a confirmed seat to any destination the airline services. Neither the exclusion of section 132(a)(1) (relating to no-additional-cost services) nor any other statutory exclusion applies to a flight taken primarily for personal purposes by an employee under this program. However, an employee discount of up to 20 percent may be excluded as a qualified employee discount. Thus, if the price charged to customers for the flight taken is $300 (under restrictions comparable to those actually placed on travel associated with the employee airline ticket), $60 is excludible from gross income as a qualified employee discount and $240 is includible in gross income.

Par. 11. Section 1.132–4 is added and reads as follows:

§ 1.132–4 Line of business limitaiton.

(a) *In general*—(1) *Applicability*—(i) *General rule.* A no-additional-cost service or a qualified employee discount provided to an employee is only available with respect to property or services that are offered for sale to customers in the ordinary course of the same line of business in which the employee receiving the property or service performs substantial services. Thus, an employee who does not perform substantial services in a particular line of business of the employer may not exclude from income under section 132 (a)(1) or (a)(2) the value of services or employee discounts received on property or services in that line of business. For rules that relax the line of business requirement, see paragraphs (b) through (g) of this section.

(ii) *Property and services sold to employees rather than customers.* Because the property or services must be offered for sale to customers in the ordinary course of the same line of business in which the employee performs substantial services, the line of business limitation is not satisfied if the employer's products or services are sold primarily to employees of the employer, rather than to customers. Thus, for example, an employer in the banking line of business is not considered in the variety store line of business if the employer establishes an employee store that offers variety store items for sale to the employer's employees. See § 1.132–7 for rules relating to employer-operated eating facilities, and see § 1.132–1(e) for rules relating to employer-operated on-premises athletic facilities.

(iii) *Performance of substantial services in more than one line of business.* An employee who performs services in more than one of the employer's lines of business may only exclude no-additional-cost services and qualified employee discounts in the lines of business in which the employee performs substantial services.

(iv) *Performance of services that directly benefit more than one line of business*—(A) *In general.* An employee who performs substantial services that directly benefit more than one line of business of an employer is treated as performing substantial services in all such line of business. For example, an employee who maintains accounting records for an employer's three lines of business may receive qualified employee discounts in all three lines of business. Similarly, if an employee of a minor line of business of an employer that is significantly interrelated with a major line of business of the employer performs substantial services that directly benefit both the major and the minor lines of business, the employee is treated as performing substantial services for both the major and the minor lines of business.

(B) *Examples.* The rules provided in this paragraph (a)(1)(iv) are illustrated by the following examples:

Example (1). Assume that employees of units of an employer provide repair or financing services, or sell by catalog, with respect to retail merchandise sold by the employer. Such employees may be considered to perform substantial services for the retail merchandise line of business under paragraph (a)(1)(iv)(A) of this section.

Example (2). Assume that an employer operates a hospital and a laundry service. Assume further that some of the gross receipts of the laundry service line of business are from laundry services sold to customers other than the hospital employer. Only the employees of the laundry service who perform substantial services which directly benefit the hospital line of business (through the provision of laundry services to the hospital) will be treated as performing substantial services for the hospital line of business. Other employees of the laundry service line of business will not be treated as employees of the hospital line of business.

Example (3). Assume the same facts as in example (2), except that the employer also operates a chain of dry cleaning stores. Employees who perform substantial services which directly benefit the dry cleaning stores but who do not perform substantial services that directly benefit the hospital line of business will not be treated as performing substantial services for the hospital line of business.

(2) *Definition*—(i) *In general.* An employer's line of business is determined by reference to the Enterprise Standard Industrial Classification Manual (ESIC Manual) prepared by the Statistical Policy Division of the U.S. Office of Management and Budget. An employer is considered to have more than one line of business if the employer offers for sale to customers property or services in more than one two-digit code classification referred to in the ESIC Manual.

(ii) *Examples.* Examples of two-digit classifications are general retail merchandise stores; hotels and other lodging places; auto repair, services, and garages; and food stores.

(3) *Aggregation of two-digit classifications.* If, pursuant to paragraph (a)(2) of this section, an employer has more than one line of business, such lines of business will be treated as a single line of business where and to the extent that one or more of the following aggregation rules apply:

(i) If it is uncommon in the industry of the employer for any of the separate lines of business of the employer to be operated without the others, the

separate lines of business are treated as one line of business.

(ii) If it is common for a substantial number of employees (other than those employees who work at the headquarters or main office of the employer) to perform substantial services for more than one line of business of the employer, so that determination of which employees perform substantial services for which line or lines of business would be difficult, then the separate lines of business of the employer in which such employees perform substantial services are treated as one line of business. For example, assume that an employer operates a delicatessen with an attached service counter at which food is sold for consumption on the premises. Assume further that most but not all employees work both at the delicatessen and at the service counter. Under the aggregation rule of this paragraph (a)(3)(ii), the delicatessen and the service counter are treated as one line of business.

(iii) If the retail operations of an employer that are located on the same premises are in separate lines of business but would be considered to be within one line of business under paragraph (a)(2) of this section if the merchandise offered for sale in such lines of business were offered for sale at a department store, then the operations are treated as one line of business. For example, assume that on the same premises an employer sells both women's apparel and jewelry. Because, if sold together at a department store, the operations would be part of the same line of business, the operations are treated as one line of business.

(b) *Grandfather rule for certain retail stores*—(1) *In general.* The line of business limitation may be relaxed under the special grandfather rule of this paragraph (b). Under this special grandfather rule, if—

(i) On October 5, 1983, at least 85 percent of the employees of one member of an affiliated group (as defined in section 1504 without regard to subsections (b)(2) and (b)(4) thereof) ("first member") were entitled to receive employee discounts at retail department stores operated by another member of the affiliated group ("second member"), and

(ii) More than 50 percent of the previous year's sales of the affiliated group are attributable to the operation of retail department stores, then, for purposes of the exclusion from gross income of a qualified employee discount, the first member is treated as engaged in the same line of business as the second member (the opeator of the retail department stores). Therefore, employees of the first member of the affiliated group may exclude from income qualified employee discounts received at the retail department stores operated by the second member. However, employees of the second member of the affiliated group may not under this paragraph (b)(1) exclude any discounts received on property or services offered for sale to customers by the first member of the affiliated group.

(2) *Taxable year of affiliated group.* If not all of the members of an affiliated group have the same taxable year, the affiliated group must designate the 12-month period to be used in determining the "previous year's sales" (as referred to in the grandfather rule of this paragraph (b)). The 12-month period designated, however, must be used on a consistent basis.

(3) *Definition of "sales."* For purposes of this paragraph (b), the term "sales" means the gross receipts of an affiliated group, based upon the accounting methods used by its members.

(4) *Retired and disabled employees.* For purposes of this paragraph (b), an employee includes any individual who was, or whose spouse was, formerly employed by the first member of an affiliated group and who separated from service with the member by reason of retirement or disability if the second member of the group provided employee discounts to tha t individual on October 5, 1983.

(5) *Increase of employee discount.* If, after October 5, 1983, the employee discount described in this paragraph (b) is increased, the grandfather rule of this paragraph (b) does not apply to the amount of the increase. For example, if on January 1, 1989, the employee discount is increased from 10 percent to 15 percent, the grandfather rule will not apply to the additional 5 percent discount.

(c) *Grandfather rule for telephone service provided to predivestiture retirees.* All entities subject to the modified final judgment (as defined in section 559(c)(5) of the Tax Reform Act of 1984) shall be treated as a single employer engaged in the same line of business for purposes of determining whether telephone service provided to certain employees is a no-additional-cost service. The preceding sentence applies only in the case of an employee who by reason of retirement or disability separated before January 1, 1984, from the service of an entity subject to the modified final judgment. This paragraph (c) only applies to services provided to such employees as of January 1, 1984. For a special no-additional-cost service rule relating to such employees and such services, see § 1.132–2(a)(6).

(d) *Special rule for certain affiliates of commercial airlines*—(1) *General rule.* If a qualified affiliate is a member of an airline affiliated group and employees of the qualified affiliate who are directly engaged in providing airline-related services are entitled to no-additional-cost service with respect to air transportation provided by such other member, then, for purposes of applying § 1.132–2 (relating to no-additional-cost services with respect to such air transportation), such qualified affiliate shall be treated as engaged in the same line of business as such other member.

(2) *"Airline affiliated group" defined.* An "airline affiliated group" is an affiliated group (as defined in section 1504 (a)) one of whose members operates a commercial airline that provides air transportation to customers on a per-seat basis.

(3) *"Qualified affiliate" defined.* A "qualified affiliate" is any corporation that is predominantly engaged in providing airline-related services. The term "airline-related services" means any of the following services provided in connection with air transportation:

(i) Catering,

(ii) Baggage handling,

(iii) Ticketing and reservations,

(iv) Flight planning and weather analysis, and

(v) Restaurants and gift shops located at an airport.

(e) *Grandfather rule for affiliated groups operating airlines.* The line of business limitation may be relaxed under the special grandfather rule of this paragraph (e). Under this special grandfather rule, if, as of September 12, 1984—

(1) An individual—

(i) Was an employee (within the meaning of § 1.132–1 (b)) of one member of an affiliated group (as defined in section 1504(a)) ("first corporation"), and

(ii) Was eligible for no-additional-cost services in the form of air transportation provided by another member of such affiliated group ("second corporation"),

(2) At least 50 percent of the individuals performing services for the first corporation were, or had been employees of, or had previously performed services for, the second corporation, and

(3) The primary business of the affiliated group was air transportation of passengers, then, for purposes of applying sections 132(a) (1) and (2), with respect to no-additional-cost services and qualified employee discounts

provided after December 31, 1984, for that individual by the second corporation, the first corporation is treated as engaged in the same air transporation line of business as the second corporation. For purposes of the preceding sentence, an employee of the second corporation who is performing services for the first corporation is also treated as an employee of the first corporation.

(f) *Special rule for qualified air transportation organizations.* A qualified air transportation organization is treated as engaged in the line of busienss of providing air transportation with respect to any individual who performs services for the organization if those services are peformed primarily for persons engaged in providing air transportation, and are of a kind which (if performed on September 12, 1984) would qualify the individual for no-additional-cost services in the form of air transportation. The term "qualified air transportation organization" means any organization—

(1) If such organization (or a predecessor) was in existence on September 12, 1984,

(2) If such organization is—

(i) A tax-exempt organization under section(c)(6) whose membership is limited to entities engaged in the transportation by air of individuals or property for compensation or hire, or

(ii) Is a corporation all the stock of which is owned entirely by entities described in paragraph (f)(2)(i) of this section, and

(3) If such organization is operated in furtherance of the activities of its members or owners.

(g) *Relaxation of line of business requirement.* The line of business requirement may be relaxed under an elective grandfather rule provided in section 4977. For rules relating to the section 4977 election, see § 54.4977–1T.

(h) *Line of business requirement does not expand benefits eligible for exclusion.* The line of business requirement limits the benefits eligible for the no-additional-cost service and qualified employee discount exclusions to property or services provided by an employer to its customers in the ordinary course of the line of business of the employer in which the employee performs substantial services. The requirement is intended to ensure that employers do not offer, on a tax-free or reduced basis, property or services to employees that are not offered to the employer's customers, even if the property or services offered to the customers and the employees are within the same line of business (as defined in this section).

Par. 12. Section 1.132–5 is added and reads as follows:

§ 1.132–5 Working condition fringes.

(a) *In general*—(1) *Definition.* Gross income does not include the value of a working condition fringe. A "working condition fringe" is any property or service provided to an employee of an employer to the extent that, if the employee paid for the property or service, the amount paid would be allowable as a deduction under section 162 or 167.

(i) A service or property offered by an employer in connection with a flexible spending account is not excludable from gross income as a working condition fringe. For purposes of the preceding sentence, a flexible spending account is an agreement (whether or not written) entered into between an employer and an employee that makes available to the employee over a time period a certain level of unspecified non-cash benefits with a pre-determined cash value.

(ii) If, under section 274 or any other section, certain substantiation requirements must be met in order for a deduction under section 162 or 167 to be allowable, then those substantiation requirements apply when determining whether a property or service is excludable as a working condition fringe.

(iii) An amount that would be deductible by the employee under a section other than section 162 or 167, such as section 212, is not a working condition fringe.

(iv) A physical examination program provided by the employer is not excludable as a working condition fringe even if the value of such program might be deductible to the employee under section 213. The previous sentence applies without regard to whether the employer makes the program mandatory to some or all employees.

(v) A cash payment made by an employer to an employee will not qualify as a working condition fringe unless the employer requires the employee to—

(A) Use the payment for expenses in connection with a specific or pre-arranged activity or undertaking for which a deduction is allowable under section 162 or 167,

(B) Verify that the payment is actually used for such expenses, and

(C) Return to the employer any part of the payment not so used.

(vi) The limitation of section 67(a) (relating to the two-percent floor on miscellaneous itemized deductions) is not considered when determining the amount of a working condition fringe. For example, assume that an employer provides a $1,000 cash advance to Employee A and that the conditions of paragraph (a)(1)(v) of this section are not satisfied. Even to the extent A uses the allowance for expenses for which a deduction is allowable under section 162 and 167, because such cash payment is not a working condition fringe, section 67(a) applies. The $1,000 payment is includible in A's gross income and subject to income and employment tax withholding. If, however, the conditions of paragraph (a)(1)(v) of this section are satisfied with respect to the payment, then the amount of A's working condition fringe is determined without regard to section 67(a). The $1,000 payment is excludible from A's gross income and not subject to income and employment tax reporting and withholding.

(2) *Trade or business of the employee*—(i) *General.* If the hypothetical payment for a property or service would be allowable as a deduction with respect to a trade or business of an employee other than the employee's trade or business of being an employee of the employer, it cannot be taken into account for purposes of determining the amount, if any, of the working condition fringe.

(ii) *Examples.* The rule of paragraph (a)(2)(i) of this section may be illustrated by the following examples:

Example (1). Assume that, unrelated to company X's trade or business and unrelated to employee A's trade or business of being an employee of company X, A is a member of the board of directors of company Y. Assume further that company X provides A with air transportation to a company Y board of director's meeting. A may not exclude from gross income the value of the air transportation to the meeting as a working condition fringe. A may, however, deduct such amount under section 162 if the section 162 requirements are satisfied. The result would be the same whether the air transportation was provided in the form of a flight on a commercial airline or a seat on a company X airplane.

Example (2). Assume the same facts as in example (1) except that A serves on the board of directors of company Z and company Z regularly purchases a significant amount of goods and services from company X. Because of the relationship between Company Z and A's employer, A's membership on Company Z's board of directors is related to A's trade or business of being an employee of Company X. Thus, A may exclude from gross income the value of air transportation to board meetings as a working condition fringe.

Example (3). Assume the same facts as in example (1) except that A serves on the board of directors of a charitable organization. Assume further that the service by A on the charity's board is substantially related to company X's trade or business. In

this case, A may exclude from gross income the value of air transportation to board meetings as a working condition fringe.

Example (4). Assume the same facts as in example (3) except that company X also provides A with the use of a company X conference room which A uses for monthly meetings relating to the charitable organization. Also assume that A uses company X's copy machine and word processor each month in connection with functions of the charitable organization. Because of the substantial business benefit that company X derives from A's service on the board of the charity, A may exclude as a working condition fringe the value of the use of company X property in connection with the charitable organization.

(b) *Vehicle allocation rules*—(1) *In general*—(i) *General rule.* In general, with respect to an employer-provided vehicle, the amount excludable as a working condition fringe is the amount that would be allowable as a deduction under section 162 or 167 if the employee paid for the availability of the vehicle. For example, assume that the value of the availability of an employer-provided vehicle for a full year is $2,000, without regard to any working condition fringe (i.e., assuming all personal use). Assume Further that the employee drives the vehicle 6,000 miles for his employer's business and 2,000 miles for reasons other than the employer's business. In this situation, the value of the working condition fringe is $2,000 multiplied by a fraction, the numerator of which is the business-use mileage (6,000 miles) and the denominator of which is the total mileage (8,000 miles). Thus, the value of the working condition fringe is $1,500. The total amount includible in the employee's gross income on account of the availability of the vehicle is $500 ($2,000−$1,500). For purposes of this section, the term "vehicle" has the meaning given the term in § 1.61–21(e)(2). Generally, when determining the amount of an employee's working condition fringe, miles accumulated on the vehicle by all employees of the employer during the period in which the vehicle is available to the employee are considered. For example, assume that during the year in which the vehicle is available to the employee in the above example, other employees accumulate 2,000 additional miles on the vehicle (while the employee is not in the automobile). In this case, the value of the working condition fringe is $2,000 multiplied by a fraction, the numerator of which is the business-use mileage by the employee (including all mileage (business and personal) accumulated by other employees) (8,000 miles) and the denominator of which is the total mileage (including all mileage accumulated by other employees) (10,000 miles). Thus, the value of the working condition fringe is $1,600; the total amount includible in the employee's gross income on account of the availability of the vehicle is $400 ($2,000−$1,600). If, however, substantially all of the use of the automobile by other employees in the employer's business is limited to a certain period, such as the last three months of the year, the miles driven by the other employees during that period would not be considered when determining the employee's working condition fringe exclusion. Similarly, miles driven by other employees are not considered if the pattern of use of the employer-provided automobiles is designed to reduce Federal taxes. For example, assume that an employer provides employees A and B each with the availability of an employer-provided automobile and that A uses the automobile assigned to him 80 percent for the employer's business and that B uses the automobile assigned to him 30 percent for the employer's business. If A and B alternate the use of their assigned automobiles each week in such a way as to achieve a reduction in federal taxes, then the employer may count only miles placed on the automobile by the employee to whom the automobile is assigned when determining each employee's working condition fringe.

(ii) *Use by an individual other than the employee.* For purposes of this section, if the availability of a vehicle to an individual would be taxed to an employee, use of the vehicle by the individual is included in references to use by the employee.

(iii) *Provision of an expensive vehicle for personal use.* If an employer provides an employee with a vehicle that an employee may use in part for personal purposes, there is no working condition fringe exclusion with respect to the personal miles driven by the employee; if the employee paid for the availability of the vehicle, he would not be entitled to deduct under section 162 or 167 any part of the payment attributable to personal miles. The amount of the inclusion is not affected by the fact that the employee would have chosen the availability of a less expensive vehicle. Moreover, the result is the same even though the decision to provide an expensive rather than an inexpensive vehicle is made by the employer for bona fide noncompensatory business reasons.

(iv) *Total value inclusion.* In lieu of excluding the value of a working condition fringe with respect of an automobile, an employer using the automobile lease valuation rule of § 1.61–21(d) may include in an employee's gross income the entire Annual Lease Value of the automobile. Any deduction allowable to the employee under section 162 or 167 with respect to the automobile may be taken on the employee's income tax return. The total inclusion rule of this paragraph (b)(1)(iv) is not available if the employer is valuing the use or availability of a vehicle under general valuation principles or a special valuation rule other than the automobile lease valuation rule. See section § 1.162–25T for rules relating to the employee's deduction.

(v) *Shared usage.* In calculating the working condition fringe benefit exclusion with respect to a vehicle provided for use by more than one employee, an employer shall compute the working condition fringe in a manner consistent with the allocation of the value of the vehicle under section 1.61–21(c)(2)(ii)(B).

(2) *Use of different employer-provided vehicles.* The working condition fringe exclusion must be applied on a vehicle-by-vehicle basis. For example, assume that automobile Y is available to employee D for 3 days in January and for 5 days in March, and automobile Z is available to D for a week in July. Assume further that the Daily Lease Value, as defined in § 1.61–21(d)(4)(ii), of each automobile is $50. For the eight days of availability of Y in January and March, D uses Y 90 percent for business (by mileage). During July, D uses Z 60 percent for business (by mileage). The value of the working condition fringe is determined separately for each automobile. Therefore, the working condition fringe for Y is $360 ($400×.90) leaving an income inclusion of $40. The working condition fringe for Z is $210 ($350×.60), leaving an income inclusion of $140. If the value of the availability of an automobile is determined under the Annual Lease Value rule for one period and Daily Lease Value rule for a second period (see § 1.61–21(d)), the working condition fringe exclusion must be calculated separately for the two periods.

(3) *Provision of a vehicle and chauffeur services*—(i) *General rule.* In general, with respect to the value of chauffeur services provided by an employer, the amount excludable as a working condition fringe is the amount that would be allowable as a deduction under section 162 and 167 if the employee paid for the chauffeur services. The working condition fringe with respect to a chauffeur is determined separately from the working condition fringe with respect to the vehicle. An employee may exclude from

gross income the excess of the value of the chauffeur services over the value of the chauffeur services for personal purposes (such as commuting) as determined under § 1.61–21(b)(5). See § 1.61–21(b)(5) for additional rules and examples concerning the valuation of chauffeur services. See § 1.132–5(m)(5) for rules relating to an exclusion from gross income for the value of bodyguard/chauffeur services. When determining whether miles placed on the vehicle are for the employer's business, miles placed on the vehicle by a chauffeur between the chauffeur's residence and the place at which the chauffeur picks up (or drops off) the employee are with respect to the employee (but not the chauffeur) considered to be miles placed on the vehicle for the employer's business and thus eligible for the working condition fringe exclusion. Thus, because miles placed on the vehicle by a chauffeur between the chauffeur's residence and the place at which the chauffeur picks up (or drops off) the employee are not considered business miles with respect to the chauffeur, the value of the availability of the vehicle for commuting is includible in the gross income of the chauffeur. For general and special rules concerning the valuation of the use of employer-provided vehicles, see paragraphs (b) through (f) of § 1.61–21.

(ii) *Examples.* The rules of paragraph (b)(3)(i) of this section are illustrated by the following examples:

Example (1). Assume that an employer makes available to an employee an automobile and a chauffeur. Assume further that the value of the chauffeur services determined in accordance with § 1.61–21 is $30,000 and that the chauffeur spends 30 percent of each workday driving the employee for personal purposes. There may be excluded from the employee's income 70 percent of $30,000, or $21,000, leaving an income inclusion with respect to the chauffeur services of $9,000.

Example (2). Assume that the value of the availability of an employer-provided vehicle for a year is $4,850 and that the value of employer-provided chauffeur services with respect to the vehicle for the year is $20,000. Assume further that 40 percent of the miles placed on the vehicle are for the employer's business and that 60 percent are for other purposes. In addition, assume that the chauffeur spends 25 percent of each workday driving the employee for personal purposes (i.e., 2 hours). The value of the chauffeur services includible in the employee's income is 25 percent of $20,000, or $5,000. The excess of $20,000 over $5,000 or $15,000 is excluded from the employee's income as a working condition fringe. The amount excludable as a working condition fringe with respect to the vehicle is 40 percent of $4,850, or $1,940 and the amount includible is $4,850 − $1,940, or $2,910.

(c) *Applicability of substantiation requirements of sections 162 and 274 (d)*—(1) *In general.* The value of property or services provided to an employee may not be excluded from the employee's gross income as a working condition fringe, by either the employer or the employee, unless the applicable substantiation requirements of either section 274(d) or section 162 (whichever is applicable) and the regulations thereunder are satisfied. The substantiation requirements of section 274(d) apply to an employee even if the requirements of section 274 do not apply to the employee's employer for deduction purposes (such as when the employer is a tax-exempt organization or a governmental unit).

(2) *Section 274(d) requirements.* The substantiation requirements of section 274(d) are satisfied by "adequate records or sufficient evidence corroborating the [employee's] own statement". Therefore, such records or evidence provided by the employee, and relied upon by the employer to the extent permitted by the regulations promulgated under section 274(d), will be sufficient to substantiate a working condition fringe exclusion.

(d) *Safe harbor substantiation rules*—(1) *In general.* Section 1.274–6T provides that the substantiation requirements of section 274(d) and the regulations thereunder may be satisfied, in certain circumstances, by using one or more of the safe harbor rules prescribed in § 1.274–6T. If the employer uses one of the safe harbor rules prescribed in § 1.274–6T during a period with respect to a vehicle (as defined in § 1.61–21(e)(2)), that rule must be used by the employer to substantiate a working condition fringe exclusion with respect to that vehicle during the period. An employer that is exempt from Federal income tax may still use one of the safe harbor rules (if the requirements of that section are otherwise met during a period) to substantiate a working condition fringe exclusion with respect to a vehicle during the period. If the employer uses one of the methods prescribed in § 1.274–6T during a period with respect to an employer-provided vehicle, that method may be used by an employee to substantiate a working condition fringe exclusion with respect to the same vehicle during the period, as long as the employee includes in gross income the amount allocated to the employee pursuant to § 1.274–6T and this section. (See § 1.61–21(c)(2) for other rules concerning when an employee must include in income the amount determined by the employer.) If, however, the employer uses the safe harbor rule prescribed in § 1.274–6T(a)(2) or (3) and the employee without the employer's knowledge uses the vehicle for purposes other than de minimis personal use (in the case of the rule prescribed in § 1.274–6T(a)(2)), or for purposes other than de minimis personal use and commuting (in the case of the rule prescribed in § 1.274–6T(a)(3)), then the employees must include an additional amount in income for the unauthorized use of the vehicle.

(2) *Period for use of safe harbor rules.* The rules prescribed in this paragraph (d) assume that the safe harbor rules prescribed in § 1.274–6T are used for a one-year period. Accordingly, references to the value of the availability of a vehicle, amounts excluded as a working condition fringe, etc., are based on a one-year period. If the safe harbor rules prescribed in § 1.274–6T are used for a period of less than a year, the amounts referred to in the previous sentence must be adjusted accordingly. For purposes of this section, the term "personal use" has the same meaning as prescribed in § 1.274–6T (e)(5).

(e) *Safe harbor substantiation rule for vehicles not used for personal purposes.* For a vehicle described in § 1.274–6T(a)(2) (relating to certain vehicles not used for personal purposes), the working condition fringe exclusion is equal to the value of the availability of the vehicle if the employer uses the method prescribed in § 1.274–6T(a)(2).

(f) *Safe harbor substantiation rule for vehicles not available to employees for personal use other than commuting.* For a vehicle described in § 1.274–6T(a)(3) (relating to certain vehicles not used for personal purposes other than commuting), the working condition fringe exclusion is equal to the value of the availability of the vehicle for purposes other than commuting if the employer uses the method prescribed in § 1.274–6T(a)(3). This rule applies only if the special rule for valuing commuting use, as prescribed in § 1.61–21(f), is used and the amount determined under the special rule is either included in the employee's income or reimbursed by the employee.

(g) *Safe harbor substantiation rule for vehicles used in connection with the business of farming that are available to employees for personal use*—(1) *In general.* For a vehicle described in § 1.274–6T(b) (relating to certain vehicles used in connection with the business of farming), the working condition fringe exclusion is calculated by multiplying the value of the availability of the vehicle by 75 percent.

(2) *Vehicles available to more than one individual.* If the vehicle is available to more than one individual, the

employer must allocate the gross income inclusion attributable to the vehicle (25 percent of the value of the availability of the vehicle) among the employees (and other individuals whose use would not be attributed to an employee) to whom the vehicle was available. This allocation must be done in a reasonable manner to reflect the personal use of the vehicle by the individuals. An amount that would be allocated to a sole proprietor reduces the amounts that may be allocated to employees but is otherwise to be disregarded for purposes of this paragraph (g). For purposes of this paragraph (g), the value of the availability of a vehicle may be calculated as if the vehicle were available to only one employee continuously and without regard to any working condition fringe exclusion.

(3) *Examples.* The following examples illustrate a reasonable allocation of gross income with respect to an employer-provided vehicle between two employees:

Example (1). Assume that two farm employees share the use of a vehicle that for a calendar year is regularly used directly in connection with the business of farming and qualifies for use of the rule in § 1.274–6T(b). Employee A uses the vehicle in the morning directly in connection with the business of farming and employee B uses the vehicle in the afternoon directly in connection with the business of farming. Assume further that employee B takes the vehicle home in the evenings and on weekends. The employer should allocate all the income attributable to the availability of the vehicle to employee B.

Example (2). Assume that for a calendar year, farm employees C and D share the use of a vehicle that is regularly used directly in connection with the business of farming and qualifies for use of the rule in § 1.2.4–6T(b). Assume further that the employees alternate taking the vehicle home in the evening and alternate the availability of the vehicle for personal purposes on weekends. The employer should allocate the income attributable to the availability of the vehicle for personal use (25 percent of the value of the availability of the vehicle) equally between the two employees.

Example (3). Assume the same facts as in example (2) except that C is the sole proprietor of the farm. Based on these facts, C should allocate the same amount of income to D as was allocated to D in example (2). No other income attributable to the availability of the vehicle for personal use should be allocated.

(h) *Qualified nonpersonal use vehicles.* (1) *In general.* Except as provided in paragraph (h)(2) of this section, 100 percent of the value of the use of a qualified nonpersonal use vehicle (as described in § 1.274–5T(k)) is excluded from gross income as a working condition fringe, provided that, in the case of a vehicle described in paragraph (k) (3) through (8) of that section, the use of the vehicle conforms to the requirements of that paragraph.

(2) *Shared usage of qualified nonpersonal use vehicles.* In general, a working condition fringe under paragraph (h) of this section is available to the driver and all passengers of a qualified nonpersonal use vehicle. However, a working condition fringe under this paragraph (h) is available only with respect to the driver and not with respect to any passengers of a qualified nonpersonal use vehicle described in § 1.274–5T(k)(2)(ii) (L) or (P). In this case, the passengers must comply with provisions of this section (excluding this paragraph (h)) to determine the applicability of the working condition fringe exclusion. For example, if an employer provides a passenger bus with a capacity of 25 passengers to its employees for purposes of transporting employees to and/or from work, the driver of the bus may exclude from gross income as a working condition fringe 100 percent of the value of the use of the vehicle. The value of the commuting use of the employer-provided bus by the employee-passengers is includible in their gross incomes. See § 1.61–21(f) for a special rule to value the commuting-only use of employer-provided vehicles.

(i) [Reserved].

(j) *Application of section 280F.* In determining the amount, if any, of an employee's working condition fringe, section 280F and the regulations thereunder do not apply. For example, assume that an employee has available for a calendar year an employer-provided automobile with a fair market value of $28,000. Assume further that the special rule provided in § 1.61–21(d) is used yielding an Annual Lease Value, as defined in § 1.61–21(d), of $7,750, and that all of the employee's use of the automobile is for the employer's business. The employee would be entitled to exclude as a working condition fringe the entire Annual Lease Value, despite the fact that if the employee paid for the availability of the automobile, an income inclusion would be required under § 1.280F–6(d)(1). This paragraph (j) does not affect the applicability of section 280F to the employer with respect to such employer-provided automobile, nor does it affect the applicability of section 274 to either the employer or the employee. For rules concerning substantiation of an employee's working condition fringe, see paragraph (c) of this section.

(k) *Aircraft allocation rule.* In general, with respect to a flight on an employer-provided aircraft, the amount excludable as a working condition fringe is the amount that would be allowable as a deduction under section 162 or 167 if the employee paid for the flight on the aircraft. For example, if employee P and P's spouse fly on P's employer's airplane primarily for business reasons of P's employer so that P could deduct the expenses relating to the trip to the extent of P's payments, the value of the flights is excludable from gross income as a working condition fringe. However, if P's children accompany P on the trip primarily for personal reasons, the value of the flights by P's children are includible in P's gross income. See § 1.61–21 (g) for special rules for valuing personal flights on employer-provided aircraft.

(l) [Reserved.]

(m) *Employer-provided transportation for security concerns*—(1) *In general.* The amount of a working condition fringe exclusion with respect to employer-provided transportation is the amount that would be allowable as a deduction under section 162 or 167 if the employee paid for the transportation. Generally, if an employee pays for transportation taken for primarily personal purposes, the employee may not deduct any part of the amount paid. Thus, the employee may not generally exclude the value of employer-provided transportation as a working condition fringe if such transportation is primarily personal. If, however, for bona fide business-oriented security concerns, the employee purchases transportation that provides him or her with additional security, the employee may generally deduct the excess of the amount actually paid for the transportation over the amount the employee would have paid for the same mode of transportation absent the bona fide business-oriented security concerns. This is the case whether or not the employee would have taken the same mode of transportation absent the bona fide business-oriented security concerns. With respect to a vehicle, the phrase "the same mode of transportation" means use of the same vehicle without the additional security aspects, such as bulletproof glass. With respect to air transportation, the phrase "the same mode of transportation" means comparable air transportation. These same rules apply to the determination of an employee's working condition fringe exclusion. For example, if an employer provides an employee with a vehicle for commuting and, because of bona fide business-oriented security concerns, the vehicle is specially designed for security, then the employee may exclude from gross income the value of the special security design as a working

condition fringe. The employee may not exclude the value of the commuting from income as a working condition fringe because commuting is a nondeductible personal expense. Similarly, if an employee travels on a personal trip in an employer-provided aircraft for bona fide business-oriented security concerns, the employee may exclude the excess, if any, of the value of the flight over the amount the employee would have paid for the same mode of transportation, but for the bona fide business-oriented security concerns. Because personal travel is a nondeductible expense, the employee may not exclude the total value of the trip as a working condition fringe.

(2) *Demonstration of bona fide business-oriented security concerns*—(i) *In general.* For purposes of this paragraph (m), the existence of a bona fide business-oriented security concern for the furnishing of a specific form of transportation to an employee is determined on the basis of all facts and circumstances. Examples of factors indicating a bona fide business-oriented security concern are—

(A) *Terrorist activity.* A recent history of violent terrorist activity (such as bombings) in the geographic area in which the transportation is provided, unless that activity (*1*) is focused on a group of individuals which does not include the employee or a similarly situated employee of an employer, or (*2*) occurs to a significant degree only in a location within the geographic area where the employee does not travel;

(B) *Death threat.* A threat on the life of the employee because of the employee's status as an employee of the employer, or on the life of a similarly situated employee because of such employee's status as an employee of an employer;

(C) *Threat of kidnapping.* A threat of kidnapping the employee because of the employee's status as an employee of the employer or of kidnapping a similarly situated employee because of such employee's status as an employee of an employer; or

(D) *Threat of serious bodily harm.* A threat of imposing serious bodily harm on the employee because of the employee's status as an employee of the employer, or on a similarly situated employee because of such employee's status as an employee of an employer.

(ii) *Establishment of overall security program.* Notwithstanding anything in paragraph (m)(2)(i) of this section to the contrary, no bona fide business-oriented security concern will be deemed to exist unless the employee's employer establishes to the satisfaction of the Commissioner that an overall security program has been provided with respect to the employee involved. An overall security program is deemed to exist if the requirements of paragraph (m)(2)(iv) of this section are satisfied (relating to an independent security study).

(iii) *Overall security program*—(A) *Defined.* An overall security program is one in which security is provided to protect the employee on a 24-hour basis. The employee must be protected while at the employee's residence, while commuting to and from the employee's workplace, and while at the employee's workplace. In addition, the employee must be protected while traveling both at home and away from home, whether for business or personal purposes. An overall security program must include the provision of a bodyguard/chauffeur who is trained in evasive driving techniques; an automobile specially equipped for security; guards, metal detectors, alarms, or similar methods of controlling access to the employee's workplace and residence; and, in appropriate cases, flights on the employer's aircraft for business and personal reasons.

(B) *Application.* There is no overall security program when, for example, security is provided at the employee's workplace but not at the employee's residence. In addition, the fact that an employer requires an employee to travel on the employer's aircraft, or in an employer-provided vehicle that contains special security features, does not alone constitute an overall security program. The preceding sentence applies regardless of the existence of a corporate or other resolution requiring the employee to travel in the employer's aircraft or vehicle for personal as well as business reasons.

(iv) *Effect of an independent security study.* An overall security program with respect to an employee is deemed to exist if the conditions of this paragraph (m)(2)(iv) are satisfied:

(A) A security study is performed with respect to the employer and the employee (or a similarly situated employee of the employer) by an independent security consultant;

(B) The security study is based on an objective assessment of all facts and circumstances;

(C) The recommendation of the security study is that an overall security program (as defined in paragraph (m)(2)(iii) of this section) is not necessary and the recommendation is reasonable under the circumstances; and

(D) The employer applies the specific security recommendations contained in the security study to the employee on a consistent basis.

The value of transportation-related security provided pursuant to a security study that meets the requirements of this paragraph (m)(2)(iv) may be excluded from income if the security study conclusions are reasonable and, but for the bona fide business-oriented security concerns, the employee would not have had such security. No exclusion from income applies to security provided by the employer that is not recommended in the security study. Security study conclusions may be reasonable even if, for example, it is recommended that security be limited to certain geographic areas, as in the case in which air travel security is provided only in certain foreign countries.

(3) *Application of security rules to spouses and dependents.* (i) *In general.* If a bona fide business-oriented security concern exists with respect to an employee (because, for example, threats are made on the life of an employee), the bona fide business-oriented security concern is deemed to exist with respect to the employee's spouse and dependents to the extent provided in this paragraph (m)(3).

(ii) *Certain transportation.* If a working condition fringe exclusion is available under this paragraph (m) for transportation in a vehicle or aircraft provided for a bona fide business-oriented security concern with respect to an employee, the requirements of this paragraph (m) are deemed to be satisfied with respect to transportation in the same vehicle or aircraft provided at the same time to the employee's spouse and dependent children.

(iii) *Other.* Except as provided in paragraph (m)(3)(ii) of this section, a bona fide business oriented security concern is deemed to exist for the spouse and dependent children of the employer only if the requirements of paragraph (m)(2) (iii) or (iv) of this section are applied independently to such spouse and dependent children.

(4) *Working condition safe harbor for travel on employer-provided aircraft.* Under the safe harbor rule of this paragraph (m)(4), if, for a bona fide business-oriented security concern, the employer requires that an employee travel on an employer-provided aircraft for a personal trip, the employer and the employee may exclude from the employee's gross income, as a working condition fringe, the excess value of the aircraft trip over the safe harbor airfare without having to show what method of transportation the employee would have flown but for the bona fide business-oriented security concern. For purposes of the safe harbor rule of this paragraph (m)(4), the value of the safe harbor

airfare is determined under the non-commercial flight valuation rule of § 1.61–21(g) (regardless of whether the employer or employee elects to use such valuation rule) by multiplying an aircraft multiple of 200-percent by the applicable cents-per-mile rates and the number of miles in the flight and then adding the applicable terminal charge. The value of the safe harbor airfare determined under this paragraph (m)(4) must be included in the employee's income (to the extent not reimbursed by the employee) regardless of whether the employee or the employer uses the special valuation rule of § 1.61–21(g). The excess of the value of the aircraft trip over this amount may be excluded from gross income as a working condition fringe. If, for a bona fide business-oriented security concern, the employer requires that an employee's spouse and dependents travel on an employer-provided aircraft for a personal trip, the special rule of this paragraph (m)(4) is available to exclude the excess value of the aircraft trips over the safe harbor airfares.

(5) *Bodyguard/chauffeur provided for a bona fide business-oriented security concern.* If an employer provides an employee with vehicle transportation and a bodyguard/chauffeur for a bona fide business-oriented security concern, and but for the bona fide business-oriented security concern the employee would not have had a bodyguard or a chauffeur, then the entire value of the services of the bodyguard/chauffeur is excludable from gross income as a working condition fringe. For purposes of this section, a bodyguard/chauffeur must be trained in evasive driving techniques. An individual who performs services as a driver for an employee is not a bodyguard/chauffeur if the individual is not trained in evasive driving techniques. Thus, no part of the value of the services of such an individual is excludable from gross income under this paragraph (m)(5). (See paragraph (b)(3) of this section for rules relating to the determination of the working condition fringe exclusion for chauffeur services.)

(6) *Examples.* The provisions of this paragraph (m) may be illustrated by the following examples:

Example (1). Assume that in response to several death threats on the life of A, the president of X a multinational company, X establishes an overall security program for A, including an alarm system at A's home and guards at A's workplace, the use of a vehicle that is specially equipped with alarms, bulletproof glass, and armor plating, and a bodyguard/chauffeur. Assume further that A is driven for both personal and business reasons in the vehicle. Also, assume that but for the bona fide business-oriented security concerns, no part of the overall security program would have been provided to A. With respect to the transportation provided for security reasons, A may exclude as a working condition fringe the value of the special security features of the vehicle and the value attributable to the bodyguard/chauffeur. Thus, if the value of the specially equipped vehicle is $40,000, and the value of the vehicle without the security features is $25,000, A may determine A's inclusion in income attributable to the vehicle as if the vehicle were worth $25,000. A must include in income the value of the availability of the vehicle for personal use.

Example (2). Assume that B is the chief executive officer of Y, a multinational corporation. Assume further that there have been kidnapping attempts and other terrorist activities in the foreign countries in which B performs services and that at least some of such activities have been directed against B or similarly situated employees. In response to these activities, Y provides B with an overall security program, including an alarm system at B's home and bodyguards at B's workplace, a bodyguard/chauffeur, and a vehicle specially designed for security during B's overseas travels. In addition, assume that Y requires B to travel in Y's airplane for business and personal trips taken to, from, and within these foreign countries. Also, assume that but for bona fide business-oriented security concerns, no part of the overall security program would have been provided to B. B may exclude as a working condition fringe the value of the special security features of the automobile and the value attributable to the bodyguards and the bodyguard/chauffeur. B may also exclude the excess, if any, of the value of the flights over the amount A would have paid for the same mode of transportation but for the security concerns. As an alternative to the preceding sentence, B may use the working condition safe harbor described in paragraph (m)(4) of this section and exclude as a working condition fringe the excess, if any, of the value of personal flights in the Y airplane over the safe harbor airfare determined under the method described in paragraph (m)(4) of this section. If this alternative is used, B must include in income the value of the availability of the vehicle for personal use and the value of the safe harbor.

Example (3). Assume the same facts as in example (2) except that Y also requires B to travel in Y's airplane within the United States, and provides B with a chauffeur-driven limousine for business and personal travel in the United States. Assume further that Y also requires B's spouse and dependents to travel in Y's airplane for personal flights in the United States. If no bona fide business-oriented security concern exists with respect to travel in the United States, B may not exclude from income any portion of the value of the availability of the chauffeur or limousine for personal use in the United States. Thus, B must include in income the value of the availability of the vehicle and chauffeur for personal use. In addition, B may not exclude any portion of the value attributable to personal flights by B or B's spouse and dependents on Y's airplane. Thus, B must include in income the value attributable to the personal use of Y's airplane. See § 1.61–21 for rules relating to the valuation of an employer-provided vehicle and chauffeur, and personal flights on employer-provided airplanes.

Example (4). Assume that company Z retains an independent security consultant to perform a security study with respect to its chief executive officer. Assume further that, based on an objective assessment of the facts and circumstances, the security consultant reasonably recommends that 24-hour protection is not necessary but that the employee be provided security at his workplace and for ground transportation, but not for air transportation. If company Z follows the recommendations on a consistent basis, an overall security program will be deemed to exist with respect to the workplace and ground transportation security only.

Example (5). Assume the same facts as in example (4) except that company Z only provides the employee security while commuting to and from work, but not for any other ground transportation. Because the recommendations of the independent security study are not applied on a consistent basis, an overall security program will not be deemed to exist. Thus, the value of commuting to and from work is not excludable from income. However, the value of a bodyguard with professional security training who does not provide chauffeur or other personal services to the employee or any member of the employee's family may be excludable as a working condition fringe if such expense would be otherwise allowable as a deduction by the employee under section 162 or 167.

(n) *Product testing*—(1) *In general.* The fair market value of the use of consumer goods, which are manufactured for sale to nonemployees, for product testing and evaluation by an employee of the manufacturer outside the employer's workplace, is excludible from gross income as a working condition fringe if—

(i) Consumer testing and evaluation of the product is an ordinary and necessary business expense of the employer;

(ii) Business reasons necessitate that the testing and evaluation of the product be performed off the employer's business premises by employees (i.e., the testing and evaluation cannot be carried out adequately in the employer's office or in laboratory testing facilities);

(iii) The product is furnished to the employee for purposes of testing and evaluation;

(iv) The product is made available to the employee for no longer than necessary to test and evaluate its performance and (to the extent not exhausted) must be returned to the employer at completion of the testing and evaluation period;

(v) The employer imposes limits on the employee's use of the product that significantly reduce the value of any personal benefit to the employee; and

(vi) The employee must submit detailed reports to the employer on the testing and evaluation. The length of the testing and evaluation period must be reasonable in relation to the product being tested.

(2) *Employer-imposed limits.* The requirement of paragraph (n)(1)(v) of this section is satisfied if—

(i) The employer places limits on the employee's ability to select among different models or varieties of the consumer product that is furnished for testing and evaluation purposes; and

(ii) The employer generally prohibits use of the product by persons other than the employee and, in appropriate cases, requires the employee, to purchase or lease at the employee's own expense the same type of product as that being tested (so that personal use by the employee's family will be limited). In addition, any charge by the employer for the personal use by an employee of a product being tested shall be taken into account in determining whether the requirement of paragraph (n)(1)(v) of this section is satisfied.

(3) *Discriminating classifications.* If an employer furnishes products under a testing and evaluation program only, or presumably, to certain classes of employees (such as highly compensated employees, as defined in § 1.132–8(g)), this fact may be relevant when determining whether the products are furnished for testing and evaluation purposes or for compensation purposes, unless the employer can show a business reason for the classification of employees to whom the products are furnished (e.g., that automobiles are furnished for testing and evaluation by an automobile manufacturer to its design engineers and supervisory mechanics).

(4) *Factors that negate the existence of a product testing program.* If an employer fails to tabulate and examine the results of the detailed reports submitted by employees within a reasonable period of time after expiration of the testing period, the program will not be considered a product testing program for purposes of the exclusion of this paragraph (n). Existence of one or more of the following factors may also establish that the program is not a bona fide product testing program for purposes of the exclusion of this paragraph (n):

(i) The program is in essence a leasing program under which employees lease the consumer goods from the employer for a fee;

(ii) The nature of the product and other considerations are insufficient to justify the testing program; or

(iii) The expense of the program outweighs the benefits to be gained from testing and evaluation.

(5) *Failure to meet the requirements of this paragraph (n).* The fair market value of the use of property for product testing and evaluation by an employee outside the employee's workplace, under a product testing program that does not meet all of the requirements of this paragraph (n), is not excludable from gross income as a working condition fringe under this paragraph (n).

(6) *Example.* The rules of this paragraph (n) may be illustrated by the following example:

Example. Assume that an employer that manufactures automobiles establishes a product testing program under which 50 of its 5,000 employees test and evaluate the automobiles for 30 days. Assume further that the 50 employees represent a fair cross-section of all of the employees of the employer, such employees submit detailed reports to the employer on the testing and evaluation, the employer tabulates and examines the test results within a reasonable time, and the use of the automobiles is restricted to the employees. If the employer imposes the limits described in paragraph (n)(2) of this section, the employees may exclude the value of the use of the automobile during the testing and evaluation period.

(o) *Qualified automobile demonstration use*—(1) *In general.* The value of qualified automobile demonstration use is excludable from gross income as a working condition fringe. "Qualified automobile demonstration use" is any use of a demonstration automobile by a full-time automobile salesman in the sales area in which the automobile dealer's sales office is located if—

(i) Such use is provided primarily to facilitate the salesman's performance of services for the employer; and

(ii) There are substantial restrictions on the personal use of the automobile by the salesman.

(2) *Full-time automobile salesman*—(i) *Defined.* The term "full-time automobile salesman" means any individual who—

(A) Is employed by an automobile dealer;

(B) Customarily spends at least half of a normal business day performing the functions of a floor salesperson or sales manager;

(C) Directly engages in substantial promotion and negotiation of sales to customers;

(D) Customarily works a number of hours considered full-time in the industry (but at a rate not less than 1,000 hours per year); and

(E) Derives at least 25 percent of his or her gross income from the automobile dealership directly as a result of the activities described in paragraphs (o)(2)(i) (B) and (C) of this section.

For purposes of paragraph (o)(2)(i) (E) of this section, income is not considered to be derived directly as a result of activities described in paragraphs (o)(2)(i) (B) and (C) of this section to the extent that the income is attributable to an individual's ownership interest in the dealership. An individual will not be considered to engage in direct sales activities if the individual's sales-related activities are substantially limited to review of sales price offers from customers. An individual, such as the general manager of an automobile dealership, who receives a sales commission on the sale of an automobile is not a full-time automobile salesman unless the requirements of this paragraph (o)(2)(i) are met. The exclusion provided in this paragraph (o) is available to an individual who meets the definition of this paragraph (o)(2)(i) whether the individual performs services in addition to those described in this paragraph (o)(2)(i). For example, an individual who is an owner of the automobile dealership but who otherwise meets the requirements of this paragraph (o)(2)(i) may exclude from gross income the value of qualified automobile demonstration use. However, the exclusion of this paragraph (o) is not available to owners of large automobile dealerships who do not customarily engage in significant sales activities.

(ii) *Use by an individual other than a full-time automobile salesman.* Personal use of a demonstration automobile by an individual other than a full-time automobile salesman is not treated as a working condition fringe. Therefore, any personal use, including commuting use, of a demonstration automobile by a part-time salesman, automobile mechanic, or other individual who is not a full-time automobile salesman is not "qualified automobile demonstration use" and thus not excludable from gross income. This is the case whether or not the personal use is within the sales area (as defined in paragraph (o)(5) of this section).

(3) *Demonstration automobile.* The exclusion provided in this paragraph (o) applies only to qualified use of a demonstration automobile. A demonstration automobile is an automobile that is—

(i) Currently in the inventory of the automobile dealership; and

(ii) Available for test drives by customers during the normal business hours of the employee.

(4) *Substantial restrictions on personal use.* Substantial restrictions on the personal use of a demonstration automobile exist when all of the following conditions are satisfied:

(i) Use by individuals other than the full-time automobile salesmen (e.g., the salesman's family) is prohibited;

(ii) Use for personal vacation trips is prohibited;

(iii) The storage of personal possessions in the automobile is prohibited; and

(iv) The total use by mileage of the automobile by the salesman outside the salesman's normal working hours is limited.

(5) *Sales area—(i) In general.* Qualified automobile demonstration use consists of use in the sales area in which the automobile dealer's sales office is located. The sales area is the geographic area surrounding the automobile dealer's sales office from which the office regularly derives customers.

(ii) *Sales area safe harbor.* With respect to a particular full-time salesman, the automobile dealer's sales area may be treated as the area within a radius of the larger of—

(A) 75 miles or

(B) The one-way commuting distance (in miles) of the particular salesman from the dealer's sales office.

(6) *Applicability of substantiation requirements of sections 162 and 274(d).* Notwithstanding anything in this section to the contrary, the value of the use of a demonstration automobile may not be excluded from gross income as a working condition fringe, by either the employer or the employee, unless, with respect to the restrictions of paragraph (o)(4) of this section, the substantiation requirements of section 274(d) and the regulations thereunder are satisfied. See § 1.132–5(c) for general and safe harbor rules relating to the applicability of the substantiation requirements of section 274(d).

(7) *Special valuation rules.* See § 1.61–21(d)(6)(ii) for special rules that may be used to value the availability of demonstration automobiles.

(p) *Parking—(1) In general.* The value of parking provided to an employee on or near the business premises of the employer is excludable from gross income as a working condition fringe under the special rule of this paragraph (p). If the rules of this paragraph (p) are satisfied, the value of parking is excludable from gross income whether the amount paid by the employee for parking would be deductible under section 162. The working condition fringe exclusion applies whether the employer owns or rents the parking facility or parking space.

(2) *Reimbursement of parking expenses.* A reimbursement to the employee of the ordinary and necessary expenses of renting a parking space on or near the business premises of the employer is excludable from gross income as a working condition fringe, if, but for the parking expense, the employee would not have been entitled to receive and retain such amount from the employer. If, however an employee is entitled to retain a general transportation allowance or a similar benefit whether or not the employee has parking expenses, no portion of that allowance is excludable from gross income under this paragraph (p) even if it is used for parking expenses.

(3) *Parking on residential property.* With respect to an employee, this paragraph (p) does not apply to any parking facility or space located on property owned or leased by the employee for residential purposes.

(q) *Nonapplicability of nondiscrimination rules.* Except to the extent provided in paragraph (n)(3) of this section (relating to discriminating classifications of a product testing program), the nondiscrimination rules of section 132 (h)(1) and § 1.132–8 do not apply in determining the amount, if any, of a working condition fringe.

Par. 13. Section 1.132–6 is added and reads as follows:

§ 1.132–6 De minimis fringes.

(a) *In general.* Gross income does not include the value of a de minimis fringe provided to an employee. The term "de minimis fringe" means any property or service the value of which is (after taking into account the frequency with which similar fringes are provided by the employer to the employer's employees) so small as to make accounting for it unreasonable or administratively impracticable.

(b) *Frequency—(1) Employee-measured frequency.* Generally, the frequency with which similar fringes are provided by the employer to the employer's employees is determined by reference to the frequency with which the employer provides the fringes to each individual employee. For example, if an employer provides a free meal in kind to one employee on a daily basis, but not to any other employee, the value of the meals is not de minimis with respect to that one employee even though with respect to the employer's entire workforce the meals are provided "infrequently."

(2) *Employer-measured frequency.* Notwithstanding the rule of paragraph (b)(1) of this section, except for purposes of applying the special rules of paragraph (d)(2) of this section, where it would be administratively difficult to determine frequency with respect to individual employees, the frequency with which similar fringes are provided by the employer to the employer's employees is determined by reference to the frequency with which the employer provides the fringes to the workforce as a whole. Therefore, under this rule, the frequency with which any individual employee receives such a fringe benefit is not relevant and in some circumstances, the de minimis fringe exclusion may apply with respect to a benefit even though a particular employee receives the benefit frequently. For example, if an employer exercises sufficient control and imposes significant restrictions on the personal use of a company copying machine so that at least 85 percent of the use of the machine is for business purposes, any personal use of the copying machine by particular employees is considered to be a de minimis fringe.

(c) *Administrability.* Unless excluded by a provision of chapter 1 of the Internal Revenue Code of 1986 other than section 132(a)(4), the value of any fringe benefit that would not be unreasonable or administratively impracticable to account for is includible in the employee's gross income. Thus, except as provided in paragraph (d)(2) of this section, the provision of any cash fringe benefit is never excludable under section 132(a) as a de minimis fringe benefit. Similarly except as otherwise provided in paragraph (d) of this section, a cash equivalent fringe benefit (such as a fringe benefit provided to an employee through the use of a gift certificate or charge or credit card) is generally not excludable under section 132(a) even if the same property or service acquired (if provided in kind) would be excludable as a de minimis fringe benefit. For example, the provision of cash to an employee for a theatre ticket that would itself be excludable as a de minimis fringe (see paragraph (e)(1) of this section) is not excludable as a de minimis fringe.

(d) *Special rules—(1) Transit passes.* A public transit pass provided at a discount to defray an employee's commuting costs may be excluded from the employee's gross income as a de minimis fringe if such discount does not exceed $15 in any month. The exclusion provided in this paragraph (d)(1) also applies to the provision of tokens or fare cards that enable an individual to travel on the public transit system if the value

of such tokens and fare cards in any month does not exceed by more than $15 the amount the employee paid for the tokens and farecards for such month. Similarly, the exclusion of this paragraph (d)(1) applies to the provision of a voucher or similar instrument that is exchangeable solely for tokens, farecards, or other instruments that enable the employee to use the public transit system if the value of such vouchers and other instruments in any month does not exceed $15. The exclusion provided in this paragraph (d)(1) does not apply to the provision of any benefit to defray public transit expenses incurred for personal travel other than commuting.

(2) *Occasional meal money or local transportation fare*—(i) *General rule.* Meals, meal money or local transportation fare provided to an employee is excluded as a de minimis fringe benefit if the benefit provided is reasonable and is provided in a manner that satisfies the following three conditions:

(A) *Occasional basis.* The meals, meal money or local transportation fare is provided to the employee on an occasional basis. Whether meal money or local transportation fare is provided to an employee on an occasional basis will depend upon the frequency i.e. the availability of the benefit and regularity with which the benefit is provided by the employer to the employee. Thus, meals, meal money, or local transportation fare or a combination of such benefits provided to an employee on a regular or routine basis is not provided on an occasional basis.

(B) *Overtime.* The meals, meal money or local transportation fare is provided to an employee because overtime work necessitates an extension of the employee's normal work schedule. This condition does not fail to be satisifed merely because the circumstances giving rise to the need for overtime work are reasonably foreseeable.

(C) *Meal money.* In the case of a meal or meal money, the meal or meal money is provided to enable the employee to work overtime. Thus, for example, meals provided on the employer's premises that are consumed during the period that the employee works overtime or meal money provided for meals consumed during such period satisfy this condition.

In no event shall meal money or local transportation fare calculated on the basis of the number of hours worked (e.g., $1.00 per hour for each hour over eight hours) be considered a de minimis fringe benefit.

(ii) *Applicability of other exclusions for certain meals and for transportation provided for security concerns.* The value of meals furnished to an employee, an employee's spouse, or any of the employee's dependents by or on behalf of the employee's employer for the convenience of the employer is excluded from the employee's gross income if the meals are furnished on the business premises of the employer (see section 119). (For purposes of the exclusion under section 119, the definitions of an employee under § 1.132–1(b) do not apply.) If, for a bona fide business-oriented security concern, an employer provides an employee vehicle transportation that is specially designed for security (for example, the vehicle is equipped with bulletproof glass and armor plating), and the conditions of § 1.132–5(m) are satisfied, the value of the special security design is excludable from gross income as a working condition fringe if the employee would not have had such special security design but for the bona fide business-oriented security concern.

(iii) *Special rule for employer-provided transportation provided in certain circumstances.* (A) *Partial exclusion of value.* If an employer provides transportation (such as taxi fare to an employee for use in commuting to and/or from work because or unusual circumstances and because, based on the facts and circumstances, it is unsafe for the employee to use other available means of transportation, the excess of the value of each one-way trip over $1.50 per one-way commute is excluded from gross income. The rule of this paragraph (d)(2)(iii) is not available to a control employee as defined in § 1.61–21(f) (5) and (6).

(B) *"Unusual circumstances".* Unusual circumstances are determined with respect to the employee receiving the transportation and are based on all facts and circumstances. An example of unusual circumstances would be when an employee is asked to work outside of his normal work hours (such as being called to the workplace at 1:00 am when the employee normally works from 8:00 am to 4:00 pm). Another example of unusual circumstances is a temporary change in the employee's work schedule (such as working from 12 midnight to 8:00 am rather than from 8:00 am to 4:00 pm for a two-week period).

(C) *"Unsafe conditions".* Factors indicating whether it is unsafe for an employee to use other available means of transportation are the history of crime in the geographic area surrounding the employee's workplace or residence and the time of day during which the employee must commute.

(3) *Use of special rules or examples to establish a general rule.* The special rules provided in this paragraph (d) or examples provided in paragraph (e) of this section may not be used to establish any general rule permitting exclusion as a de minimis fringe. For example, the fact that $180 (i.e., $15 per month for 12 months) worth of public transit passes can be excluded from gross income as a de minimis fringe in a year does not mean that any fringe benefit with a value equal to or less than $180 may be excluded as a de minimis fringe. As another example, the fact that the commuting use of an employer-provided vehicle more than one day a month is an example of a benefit not excludable as a de minimis fringe (see paragraph (e)(2) of this section) does not mean that the commuting use of a vehicle up to 12 times per year is excludable from gross income as a de minimis fringe.

(4) *Benefits exceeding value and frequency limits.* If a benefit provided to an employee is not de minimis because either the value or frequency exceeds a limit provided in this paragraph (d), no amount of the benefit is considered to be a de minimis fringe. For example, if an employer provides a $20 monthly public transit pass, the entire $20 must be included in income, not just the excess value over $15.

(e) *Examples*—(1) *Benefits excludable from income.* Examples of de minimis fringe benefits are occasional typing of personal letters by a company secretary; occasional personal use of an employer's copying machine, provided that the employer exercises sufficient control and imposes significant restrictions on the personal use of the machine so that at least 85 percent of the use of the machine is for business purposes; occasional cocktail parties, group meals, or picnics for employees and their guests; traditional birthday or holiday gifts of property (not cash) with a low fair market value; occasional theater or sporting event tickets; coffee, doughnuts, and soft drinks; local telephone calls; and flowers, fruit, books, or similar property provided to employees under special circumstances (e.g., on account of illness, outstanding performance, or family crisis).

(2) *Benefits not excludable as de minimis fringes.* Examples of fringe benefits that are not excludable from gross income as de minimis fringes are: season tickets to sporting or theatrical events; the commuting use of an employer-provided automobile or other vehicle more than one day a month; membership in a private country club or athletic facility, regardless of the frequency with which the employee uses the facility; employer-provided group-term life insurance on the life of the spouse or child of an employee; and use

of employer-owned or leased facilities (such as an apartment, hunting lodge, boat, etc.) for a weekend. Some amount of the value of certain of these fringe benefits may be excluded from income under other statutory provisions, such as the exclusion for working condition fringes. See § 1.132–5.

(f) *Nonapplicability of nondiscrimination rules.* Except to the extent provided in § 1.132–7, the nondiscrimination rules of section 132(h)(1) and § 1.132–8 do not apply in determining the amount, if any, of a de minimis fringe. Thus, a fringe benefit may be excludable as a de minimis fringe even if the benefit is provided exclusively to highly compensated employees of the employer.

Par. 14. Section 1.132–7 is added and reads as follows:

§ 1.132–7 Employer-operated eating facilities.

(a) *In general*—(1) *Condition for exclusion*—(i) *General rule.* The value of meals provided to employees at an employer-operated eating facility for employees is excludable from gross income as a de minimis fringe only if on an annual basis, the revenue from the facility equals or exceeds the direct operating costs of the facility.

(ii) *Additional condition for highly compensated employees.* With respect to any highly compensated employee, an exclusion is available under this section only if the condition set out in paragraph (a)(1)(i) of this section is satisfied and access to the facility is available on substantially the same terms to each member of a group of employees that is defined under a reasonable classification set up by the employer that does not discriminate in favor of highly compensated employees. See § 1.132–8. For purposes of this paragraph (a)(1)(ii), each dining room or cafeteria in which meals are served is treated as a separate eating facility, whether each such dining room or cafeteria has its own kitchen or other food-preparation area.

(2) *Employer-operated eating facility for employees.* An employer-operated eating facility for employees is a facility that meets all of the following conditions—

(i) The facility is owned or leased by the employer,

(ii) The facility is operated by the employer,

(iii) The facility is located on or near the business premises of the employer, and

(iv) The meals furnished at the facility are provided during, or immediately before or after, the employee's workday.

For purposes of this section, the term "meals" means food, beverages, and related services provided at the facility. If an employer can reasonably determine the number of meals that are excludable from income by the recipient employees under section 119, the employer may, in determining whether the requirement of paragraph (a)(1)(i) of this section is satisfied, disregard all costs and revenues attributable to such meals provided to such employees. If an employer can reasonably determine the number of meals received by volunteers who receive food and beverages at a hospital, free or at a discount, the employer may, in determining whether the requirement of paragraph (a)(1)(i) of this section is satisfied, disregard all costs and revenues attributable to such meals provided to such volunteers. If an employer charges nonemployees a greater amount than employees, in determining whether the requirement of paragraph (a)(1)(i) of this section is satisfied, the employer must disregard all costs and revenues attributable to such meals provided to such nonemployees.

(3) *Operation by the employer.* If an employer contracts with another to operate an eating facility for its employees, the facility is considered to be operated by the employer for purposes of this section. If an eating facility is operated by more than one employer, it is considered to be operated by each employer.

(4) *Example.* The provisions of this paragraph (a)(2) may be illustrated by the following example:

Example (1). Assume that a not-for-profit hospital system maintains cafeterias for the use of its employees and volunteers. Only the employees are charged for food service at the cafeteria and the policy of the hospital is to charge the employees only for the costs of food, beverage and labor directly attributable to the meal. Most of the cafeterias within the system furnish more free meals to volunteers than they serve paid meals to employees. For purposes of this paragraph, as long as the employer can accurately determine the number of meals received free or at a discount by volunteers, the employer may disregard all the costs and revenues attributable to such meals provided to volunteers. Therefore, for purposes of this paragraph, the costs of the hospital system for furnishing meals to employees who pay for them are the costs to be compared to determine if the revenues from the facility equal or exceed direct operating costs of the facility's service to employees.

(b) *Direct operating costs*—(1) *In general.* For purposes of this section, the direct operating costs of an eating facility are—

(i) The cost of food and beverages, and

(ii) The cost of labor for personnel whose services relating to the facility are performed primarily on the premises of the eating facility. Direct operating costs do not include the labor cost attributable to personnel whose services relating to the facility are not performed primarily on the premises of the eating facility. Thus, for example, the labor costs attributable to cooks, waiters, and waitresses are included in direct operating costs, but the labor cost attributable to a manager of an eating facility whose services relating to the facility are not primarily performed on the premises of the eating facility is not included in direct operating costs. If an employee performs services relating to the facility both on and off the premises of the eating facility, only the portion of the total labor cost of the employee relating to the facility that bears the same proportion to such total labor cost as time spent on the premises bears to total time spent performing services relating to the facility is included in direct operating costs. For example, assume that 60 percent of the services of a cook in the above example are not related to the eating facility. Only 40 percent of the total labor cost of the cook is includible in direct operating costs. For purposes of this section, labor costs include all compensation required to be reported on a Form W–2 for income tax purposes and related employment taxes paid by the employer. In determining the direct operating costs of an eating facility, the employer may include as part of the facility, vending machines that are provided by the employer and located on the same premises as the other eating facilities operated by the employer.

(2) *Multiple dining rooms or cafeterias.* The direct operating costs test may be applied separately for each dining room or cafeteria. Alternatively, the direct operating costs test may be applied with respect to all the eating facilities operated by the employer.

(3) *Payment to operator of facility.* If an employer contracts with another to operate an eating facility for its employees, the direct operating costs of the facility consist both of direct operating costs, if any, incurred by the employer and the amount paid to the operator of the facility to the extent that such amount is attributable to what would be direct operating costs if the employer operated the facility directly.

(c) *Valuation of non-excluded meals provided at an employer-operated eating facility for employees.* If the exclusion for meals provided at an employer-operated eating facility for employees is not available, the recipient

of meals provided at such facility must include in income the amount by which the fair market value of the meals provided exceeds the sum of—

(1) The amount, if any, paid for the meals, and

(2) The amount, if any, specifically excluded by another section of chapter 1 of this subtitle.

For special valuation rules relating to such meals, see § 1.61–21(j).

Par. 15. Section 1.132–8 is added and reads as follows:

§ 1.132–8 Fringe benefit nondiscrimination rules.

(a) *Application of nondiscrimination rules*—(1) *General rule.* A highly compensated employee who receives a no-additional cost service, a qualified employee discount or a meal provided at an employer-operated eating facility for employees shall not be permitted to exclude such benefit from his or her income unless the benefit is available on substantially the same terms to:

(i) All employees of the employer; or

(ii) A group of employees of the employer which is defined under a reasonable classification set up by the employer that does not discriminate in favor of highly compensated employees. See paragraph (f) of this section for the definition of a highly compensated employee.

(2) *Consequences of discrimination*—(i) *In general.* If an employer maintains more than one fringe benefit program, i.e., either different fringe benefits being provided to the same group of employees, or different classifications of employees or the same fringe benefit being provided to two or more classifications of employees, the nondiscrimination requirements of section 132 will generally be applied separately to each such program. Thus, a determination that one fringe benefit program discriminates in favor of highly compensated employees generally will not cause other fringe benefit programs covering the same highly compensated employees to be treated as discriminatory. If the fringe benefits provided to a highly compensated individual do not satisfy the nondiscrimination rules provided in this section, such individual shall be unable to exclude from gross income any portion of the benefit. For example, if an employer offers a 20 percent discount (which otherwise satisfies the requirements for a qualified employee discount) to all non-highly compensated employees and a 35 percent discount to all highly compensated employees, the entire value of the 35 percent discount (not just the excess over 20 percent) is includible in the gross income and wages of the highly compensated employees who make purchases at a discount.

(ii) *Exception*—(A) *Related fringe benefit programs.* If one of a group of fringe benefit programs discriminates in favor of highly compensated employees, no related fringe benefit provided to such highly compensated employees under any other fringe benefit program may be excluded from the gross income of such highly compensated employees. For example, assume a department store provides a 20 percent merchandise discount to all employees under one fringe benefit program. Assume further that under a second fringe benefit program, the department store provides an additional 15 percent merchandise discount to a group of employees defined under a classification which discriminates in favor of highly compensated employees. Because the second fringe benefit program is discriminatory, the 15 percent merchandise discount provided to the highly compensated employees is not a qualified employee discount. In addition, because the 20 percent merchandise discount provided under the first fringe benefit program is related to the fringe benefit provided under the second fringe benefit program, the 20 percent merchandise discount provided the highly compensated employees is not a qualified employee discount. Thus, the entire 35 percent merchandise discount provided to the highly compensated employees is includible in such employees' gross incomes.

(B) *Employer operated eating facilities for employees.* For purposes of paragraph (a)(2)(ii)(A) of this section, meals at different employer-operated eating facilities for employees are not related fringe benefits, so that a highly compensated employee may exclude from gross income the value of a meal at a nondiscriminatory facility even though any meals provided to him or her at a discriminatory facility cannot be excluded.

(3) *Scope of the nondiscrimination rules provided in this section.* The nondiscrimination rules provided in this section apply only to fringe benefits provided pursuant to section 132 (a)(1), (a)(2), and (e)(2). These rules have no application to any other employee benefit that may be subject to nondiscrimination requirements under any other section of the Code.

(b) *Aggregation of employees*—(1) *Section 132(a) (1) and (2).* For purposes of determining whether the exclusions for no-additional-cost services and qualified employee discounts are available to highly compensated employees, the nondiscrimination rules of this section are applied by aggregating the employees of all related employers (as defined in § 1.132–1(c)), except that employees in different lines of business (as defined in § 1.132–4) are not to be aggregated. Thus, in general, for purposes of this section, the term "employees of the employer" refers to all employees of the employer and any other entity that is a member of a group described in sections 414 (b), (c), (m), or (o) and that performs services within the same line of business as the employer which provides the particular fringe benefit. Employees in different lines of business will be aggregated, however, if the line of business limitation has been relaxed pursuant to paragraphs (b) through (g) of § 1.132–4.

(2) *Section 132 (e) (2).* For purposes of determining whether the exclusions for meals provided at employer-operated eating facilities are available to highly compensated, the nondiscrimination rules of this section are applied by aggregating the employees of all related employers (as defined in section § 1.132–1(c)) who regularly work at or near the premises on which the eating facility is located, except that employees in different lines of business (as defined in § 1.132–4) are not to be aggregated. The nondiscrimination rules of this section are applied separately to each eating facility. Each dining room or cafeteria in which meals are served is treated as a separate eating facility, regardless of whether each such dining room or cafeteria has its own kitchen or other food-preparation area.

(3) *Classes of employees who may be excluded.* For purposes of applying the nondiscrimination rules of this section to a particular fringe benefit program, there may be excluded from consideration employees who may be excluded from consideration under section 89(h), as enacted by the Tax Reform Act of 1986, Pub. L. 99–514, 100 Stat. 2085 (1986) and amended by the Technical and Miscellaneous Revenue Act of 1988, Pub. L. 100–647, 102 Stat. 3342 (1988).

(c) *Availability on substantially the same terms*—(1) *General rule.* The determination of whether a benefit is available on substantially the same terms shall be made upon the basis of the facts and circumstances of each situation. In general, however, if any one of the terms or conditions governing the availability of a particular benefit to one or more employees varies from any one of the terms or conditions governing the availability of a benefit made available to one or more other employees, such benefit shall not be considered to be available on substantially the same

terms except to the extent otherwise provided in paragraph (c)(2) of this section. For example, if a department store provides a 20 percent qualified employee discount to all of its employees on all merchandise, the substantially the same terms requirement will be satisfied. Similarly, if the discount provided to all employees is 30 percent on certain merchandise (such as apparel), and 20 percent on all other merchandise, the substantially the same terms requirement will be satisfied. However, if a department store provides a 20 percent qualified employee discount to all employees, but as to the employees in certain departments, the discount is available upon hire, and as to the remaining departments, the discount is only available when an employee has completed a specified term of services, the 20 percent discount is not available on substantially the same terms to all of the employees of the employer. Similarly, if a greater discount is given to employees with more seniority, full-time work status, or a particular job description, such benefit (i.e., the discount) would not be available to all employees eligible for the discount on substantially the same terms, except to the extent otherwise provided in paragraph (c)(2) of this section. These examples also apply to no-additional-cost-services. Thus, if an employer charges non-highly compensated employees for a no-additional-cost service and does not charge highly compensated employees (or charges highly compensated employees a lesser amount), the substantially the same terms requirement will not be satisfied.

(2) *Certain terms relating to priority.* Certain fringe benefits made available to employees are available only in limited quantities that may be insufficient to meet employee demand. This situation may occur either because of employer policy (such as where an employer determines that only a certain number of units of a specific product will be made available to employees each year) or because of the nature of the fringe benefit (such as where an employer provides a no-additional-cost transportation service that is limited to the number of seats available just before departure). Under these circumstances, an employer may find it necessary to establish some method of allocating the limited fringe benefits among the employees eligible to receive the fringe benefits. The employer may establish the priorities described below.

(i) *Priority on a first come, first served, or similar basis.* A benefit shall not fail to be treated as available to a group of employees on substantially the same terms merely because the employer allocates the benefit among such employees on a "first come, first served" or lottery basis, provided that the same notice of the terms of availability is given to all employees in the group and the terms under which the benefit is provided to employees within the group are otherwise the same with respect to all employees. For purposes of the preceding sentence, a program that gives priority to employees who are the first to submit written requests for the benefit will constitute priority on a "first come, first served" basis. Similarly, if the employer regularly engages in the practice of allocating benefits on a priority basis to employees demonstrating a critical need, such benefit shall not fail to be treated as available on substantially the same terms to all of the employees with respect to whom such priority status is available as long as the determination is based upon uniform and objective criteria which have been communicated to all employees in the group of eligible employees. An example of a critical need would be priority transportation given to an employee in the event of a medical emergency involving the employee (or a member of the employee's immediate family) or a recent death in the employee's immediate family. Frustrated vacation plans or forfeited deposits would not be treated as giving rise to particularly critical needs.

(ii) *Priority on the basis of seniority.* Solely for purposes of § 1.132–8, a benefit shall not fail to be treated as available to a group of employees of the employer on substantially the same terms merely because the employer allocates the benefit among such employees on a seniority basis provided that:

(A) The same notice of the terms of availability is given to all employees in the group; and

(B) The average value of the benefit provided for each nonhighly compensated employee is at least 75% of that provided for each highly compensated employee. For purposes of this test, the average value of the benefit provided for each nonhighly compensated (highly compensated) employee is determined by taking the sum of the fair market values of such benefit provided to all the nonhighly compensated (highly compensated) employees, determined in accordance with § 1.61–21, and then dividing that sum by the total number of nonhighly compensated (highly compensated) employees of the employer. For purposes of determining the average value of the benefit provided for each employee, all employee's of the employer are counted, including those who are not eligible to receive the benefit from the employer.

(d) *Testing for discrimination.*

(1) *Classification test.* In the event that a benefit described in section 132 (a)(1), (a)(2) or (e)(2) is not available on substantially the same terms to all of the employees of the employer, no exclusion shall be available to a highly compensated employee for such benefit unless the program under which the benefit is provided satisfies the nondiscrimination standards set forth in this section. The nondiscrimination standard of this section will be satisfied only if the benefit is available on substantially the same terms to a group of employees of the employer which is defined under a reasonable classification established by the employer that does not discriminate in favor of highly compensated employees. The determination of whether a particular classification is discriminatory will generally depend upon the facts and circumstances involved, based upon principles similar to those applied for purposes of section 410(b)(2)(A)(i) or, for years commencing prior to January 1, 1988, section 410(b)(1)(B). Thus, in general, except as otherwise provided in this section, if a benefit is available on substantially the same terms to a group of employees which, when compared with all of the other employees of the employer, constitutes a nondiscriminatory classification under section 410(b)(2)(A)(i) (or, if applicable, section 410(b)(1)(B)), it shall be deemed to be nondiscriminatory.

(2) *Classifications that are per se discriminatory.* A classification that, on its face, makes fringe benefits available principally to highly compensated employees is per se discriminatory. In addition, a classification that is based on either an amount or rate of compensation is per se discriminatory if it favors those with the higher amount or rate of compensation. On the other hand, a classification that is based on factors such as seniority, full-time vs. part-time employment, or job description is not per se discriminatory but may be discriminatory as applied to the workforce of a particular employer.

(3) *Former employees.* When determining whether a classification is discriminatory, former employees shall be tested separately from other employees of the employer. Therefore, a classification is not discriminatory solely because the employer does not

make fringe benefits available to any former employee. Whether a classification of former employees discriminates in favor of highly compensated employees will depend upon the particular facts and circumstances.

(4) *Restructuring of benefits.* For purposes of testing whether a particular group of employees would constitute a discriminatory classification for purposes of this section, an employer may restructure its fringe benefit program as described in this paragraph. If a fringe benefit is provided to more than one group of employees, and one or more such groups would constitute a discriminatory classification if considered by itself, then for purposes of this section, the employer may restructure its fringe benefit program so that all or some of the members of such group may be aggregated with another group, provided that each member of the restructured group will have available to him or her the same benefit upon the same terms and conditions. For example, assume that all highly compensated employees of an employer have fewer than five years of service and all nonhighly compensated employees have over five years of service. If the employer provided a five percent discount to employees with under five years of service and a ten percent discount to employees with over five years of service, the discount program available to the highly compensated employees would not satisfy the nondiscriminatory classification test; however, as a result of the rule described in this paragraph (d)(4), the employer could structure the program to consist of a five percent discount for all employees and a five percent additional discount for nonhighly compensated employees.

(5) *Employer-operated eating facilities for employees*—(i) *General rule.* If access to an employer-operated eating facility for employees is available to a classification of employees that discriminates in favor of highly compensated employees, then the classification will not be treated as discriminating in favor of highly compensated employees unless the facility is used by one or more executive group employees more than a de minimis amount.

(ii) *Executive group employee.* For purposes of this paragraph (d)(5), an employee is an "executive group employee" if the definition of paragraph (f)(1) of this section is satisfied. For purposes of identifying such employees, the phrase "top one percent of the employees" is substituted for the phrase "top ten percent of the employees" in section 414(q)(4) (relating to the definition of "top-paid group").

(e) *Cash bonuses or rebates.* A cash bonus or rebate provided to an employee by an employer that is determined with reference to the value of employer-provided property or services purchased by the employee, is treated as an equivalent employee discount. For example, assume a department store provides a 20 percent merchandise discount to all employees under a fringe benefit program. In addition, assume that the department store provides cash bonuses to a group of employees defined under a classification which discriminates in favor of highly compensated employees. Assume further that such cash bonuses equal 15 percent of the value of merchandise purchased by each employee. This arrangement is substantively identical to the example described in paragraph (e)(2)(i) of this section concerning related fringe benefit programs. Thus, both the 20 percent merchandise discount and the 15 percent cash bonus provided to the highly compensated employees are includible in such employees' gross incomes.

(f) *Highly compensated employee*—(1) *Government and nongovernment employees.* A highly compensated employee of any employer is any employee who, during the year or the preceding year—

(i) Was a 5-percent owner,

(ii) Received compensation from the employer in excess of $75,000,

(iii) Received compensation from the employer in excess of $50,000 and was in the top-paid group of employees for such year, or

(iv) Was at any time an officer and received compensation greater than 150 percent of the amount in effect under section 415(c)(1)(A) for such year.

For purposes of determining whether an employee is a highly compensated employee, the rules of sections 414 (q), (s), and (t) apply.

(2) *Former employees.* A former employee shall be treated as a highly compensated employee if—

(i) The employee was a highly compensated employee when the employee separated from service, or

(ii) The employee was a highly compensated employee at any time after attaining age 55.

Par. 16. Section 1.912–2 is revised to read as follows:

§ 1.912–2 Exclusion of certain allowances of Foreign Service personnel.

Gross income does not include amounts received by personnel of the Foreign Service of the United States as allowances or otherwise under the provisions of chapter 9 of title I of the Foreign Service Act of 1980 or the provisions of section 28 of the State Department Basic Authorities Act (formerly section 914 of title IX of the Foreign Service Act of 1946).

PART 602—[AMENDED]

Par. 17. The authority for Part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

§ 602.101 [Amended]

Par. 18. Section 602.101 (c) is revised by inserting in the appropriate places in the table "§ 1.61–2 . . . 1545–0771"; "§ 1.132–2 . . . 1545–0771"; and "§ 1.132–5 . . . 1545–0771".

Michael J. Murphy,

Acting Commissioner of Internal Revenue.

Approved: March 20, 1989.

Dennis Earl Ross,

Acting Assistant Secretary of the Treasury

[FR Doc. 89–15645 Filed 7–5–89; 8:45 am]

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Thursday
July 6, 1989

Part III

Environmental Protection Agency

40 CFR Part 131

Water Quality Standards for the Colville Indian Reservation in the State of Washington; Final Rule

ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 131

[WH-FRL-3539-9]

Water Quality Standards for the Colville Indian Reservation in the State of Washington

AGENCY: Environmental Protection Agency.

ACTION: Final rule.

SUMMARY: This rule establishes Federal water quality standards on the Colville Confederated Tribes Reservation located within the State of Washington. The standards consist of designated uses and criteria for all surface waters on the reservation.

EFFECTIVE DATE: August 7, 1989.

ADDRESSES: The public may inspect the administrative record for this rulemaking and all comments received on the proposed regulation at the Environmental Protection Agency, Region X, 1200 Sixth Avenue, Seattle, WA 981001 between the hours of 8:00 am and 4:00 p.m. on business days. A reasonable fee will be charged for copying. Portions of the record, including the correspondence and other actions cited in this rulemaking and written public comments will be available from the Criteria and Standards Division, OWRS, 401 M Street SW., Room 919 East Tower, Washington DC 20460, during usual business hours. Inquiries can be made over the phone by calling (206) 442–8293 or (202) 475–7315.

FOR FURTHER INFORMATION CONTACT: Fletcher Shives, Environmental Protection Agency, Region X (M/S 433), 1200 Sixth Avenue, Seattle, WA 98101, (206) 442–8293.

SUPPLEMENTARY INFORMATION:

Information in this preamble is organized as follows:

A. Background

On February 7, 1986, the Environmental Protection Agency received a request from the Colville Confederated Tribes to promulgate the Tribes water quality standards as Federal standards for waters of the reservation. Although Tribal standards had recently been adopted, the Tribe was concerned that their standards were not Federally recognized under Clean Water Act ("CWA" or "the Act") section 303.

Section 303(c)(4) of the CWA authorizes the EPA Administrator to promulgate Federal water quality standards for waters of the Nation, including waters on Indian lands, whenever he determines a revised or new standard is "necessary to meet the requirements of the Act." The CWA does not, by itself, authorize States to implement or enforce water quality management programs on Indian lands. In some cases a State may have authority to regulate the water quality of a particular Indian land because of a treaty or a Federal statute. Where State authority may be in doubt, it may be appropriate for EPA to promulgate Federal water quality standards for waters on Indian lands.

Subsequent to receiving the request from the Colville Confederated Tribes, Congress passed the CWA amendments of 1987. These amendments established in the Act a new section 518 which addresses the issue of water quality standards on Indian lands and directs EPA to promulgate regulations specifying how Indian Tribes shall be treated as States for purposes of the water quality standards program. Despite the pending opportunity to qualify to be treated as a State for purposes of water quality standards, the Colville Confederated Tribes, in commenting on the proposed rulemaking, expressed enthusiastic support for EPA's action to promulgate Federal water quality standards for the reservation.

EPA is in the process of responding to the Section 518 directive to specify how Indian Tribes shall be treated as States for purposes of water quality standards. If, after promulgation of the regulations pursuant to section 518, the Colville Confederated Tribes qualify for the standards program and submit standards which are approved by EPA, EPA will withdraw these Federal water quality standards at the Tribes request.

EPA notes that today's rule does not establish a precedent for future EPA promulgations. This promulgation action is unique because: (1) It was initiated before the 1987 amendments to the Clean Water Act were enacted, and (2) it is based on water quality standards previously developed by the Colville Confederated Tribes for application to waters on their reservation. This process is not intended as a model for other reservations. Where other Indian Tribes wish to establish standards under the CWA, EPA would expect such Tribes to apply, under the CWA section 518 regulation, to be treated as States for purposes of water quality standards. Once recognized by EPA as qualified to be treated as States, such Tribes would be responsible for developing their own water quality standards under the Act and making ongoing refinements to suit particular Tribal needs.

Indian Tribes should not conclude from today's action that Federal promulgation is EPA's preferred method of establishing water quality standards on reservations. Historically, EPA's preference has been to work cooperatively with States on water quality standards issues and to initiate Federal promulgation actions only where absolutely necessary. EPA believes that this preference is consistent with the intent of the Act to provide States, and Tribes qualifying for treatment as States, with the first opportunity to set standards. Today's rule represents only the ninth Federal promulgation of water quality standards to be completed by EPA. Six of the eight completed Federal promulgations have been withdrawn. Tribes should also note that Federal promulgation of water quality standards is a very deliberate process. In the case of today's rule, it took EPA more than three years (from the time of the request by the Colville Confederated Tribes until today's final action) to promulgate final water quality standards.

The CWA amendments of 1987 also added new section 303(c)(2)(B), which requires that States "* * * shall adopt criteria for all toxic pollutants listed pursuant to section 307(a)(1) of this Act for which criteria have been published under section 304(a), the discharge or presence of which in the affected waters could reasonably be expected to interfere with those designated uses." As part of the proposed rulemaking, EPA decided not to propose numeric criteria for section 307(a) pollutants for inclusion in the Colville reservation water quality standards.

In response to comments received on the proposed rulemaking, EPA considered promulgating today's rule as proposed and simultaneously proposing numeric toxics criteria for the reservation. EPA decided against this action primarily because there are no known or suspected sources of toxics on the reservation. The Colville Confederated Tribes report only one point source discharger on the reservation and no toxics discovered from that discharger. EPA is aware of no other sources or potential sources of toxics in the area. Although the State of Washington has adopted twenty numeric toxics criteria for the protection of aquatic life, and the State and the

Tribes have an agreement to maintain consistent standards on common bodies of water, EPA is not a party to this agreement. For the reasons stated above, it is EPA's judgment that toxics criteria should not be proposed at this time.

This decision does not preclude the Tribes from amending their own water quality standards to include toxics criteria. Tribal adoption would allow the Tribes to develop any associated monitoring capabilities or otherwise make arrangements for such monitoring without EPA intervention.

Until numeric toxics criteria are adopted by EPA (or by the Tribes if they qualify for treatment as a State for purposes of the standards program) in response to additional information substantiating the need for numeric toxics criteria, EPA will use the Agency's 304(a) criteria guidance to implement the narrative toxics "free from" criterion in any situation that might arise concerning the discharge of toxics.

EPA believes this decision is appropriate, under the present circumstances, and that it is consistent with CWA section 303(c)(2)(B) and EPA's Indian Policy. This decision was made after careful consideration of the available information and the somewhat transitional nature of water quality management on the reservation (i.e., the pending CWA section 518 regulations). The decision not to adopt numeric toxics criteria for the reservation should not be interpreted as a general reluctance on the part of the Agency to adopt numeric toxics criteria, nor does it preclude proposing such criteria in the future.

Additional background information can be found in the proposed rulemaking, which appeared in the **Federal Register** on July 15, 1988 (53 FR26968). Public comments on the proposal were invited until September 13, 1988. A public hearing was held August 18, 1988 on the Colville Indian Reservation in Nespelem, Washington. Fourteen people attended this hearing. EPA received four letters and statements on the proposal.

B. Response to Public Comments

Comments on the proposed rulemaking were received from the Colville Confederated Tribes, the Puyallup Tribe, Cavenham Forest Industries, Inc., and the State of Washington Department of Ecology (DOE). These comments and EPA's responses are presented below.

One commenter strongly suggested that EPA should withdraw the proposed rule. The commenter asserted that it is unnecessary for EPA to promulgate water quality standards under section 303(c)(4)(B) of the Act because the State of Washington has already adopted and implemented standards for the reservation. The commenter contested EPA's assertion that the Act does not authorize States to implement or enforce their water quality standards on Indian lands. The commenter cited section 510 of the Act as evidence that the Act does not preempt state jurisdiction.

EPA disagrees with this analysis. Under accepted principles of Federal Indian Law, State authority to regulate activities on Indian lands is generally preempted absent an explicit Congressional statute to the contrary. *California* v. *Cabazon Band of Mission Indians*, 107 S.Ct. 1083, 1092 and n.18 (1987). The CWA contains no language which explicitly grants a State the authority to regulate activities related to water quality management on Indian lands. Section 510 of the Act clarifies only that the CWA does not preempt a State from adopting any water quality standard or effluent limitation more stringent than the Federal minima. *International Paper Co.* v. *Ouelette*, 107 S.Ct. 805 (1987). Section 510 does not, however, address the authority of a State to implement or enforce its water quality standards on Indian lands.

EPA construes the CWA in a manner very similar to the Resource, Conservation and Recovery Act (RCRA) with respect to Congressional authorization of State jurisdiction on Indian lands. As with the CWA, RCRA does not explicitly discuss or address the extent of a State's authority to regulate environmental activities on Indian lands. On this basis, EPA decided in 1983 not to authorize the State of Washington to regulate hazardous waste activities on Indian lands in the State (48 FR 34954 (1983)). EPA rejected Washington's argument that the statutory language of RCRA authorized the State's assertion of jurisdiction over Indian lands within the State. This decision was upheld by the U.S. Court of Appeals for the Ninth Circuit. *Washington Dept. of Ecology* v. EPA, 752 F.2d 1465 (9th Cir. 1985). The court found that, in light of Congressional silence, EPA had reasonably interpreted RCRA not to grant the State jurisdiction over activities on Indian lands. The court noted that EPA's interpretation was "buttressed by well-settled principles of Federal Indian law." *Id.* at 1469. As with RCRA, EPA rejects the argument that the CWA constitutes Congressional authorization of State regulatory jurisdiction over discharges to surface waters on Indian lands.

The same commenter also argued that the State retains inherent authority to regulate water quality on fee lands owned by non-Indians. This commenter asserted that EPA promulgation of water quality standards for the Colville reservation is unnecessary because the State of Washington has already established water quality standards which apply, at a minimum, over fee lands owned by non-Indians within the exterior boundaries of the reservation. EPA does not believe it necessary to resolve this issue. First, the Tribe and Washington have an agreement that water quality standards on and off the reservation will be as similar as possible. Also, the State of Washington, in a companion agreement with EPA, has already agreed that, in the absence of Tribal NPDES program assumption, EPA will issue all future NPDES permits on the reservation (without conceding its own authority to do so under State law).[1] As a result, to give effect to these agreements, EPA believes it necessary and appropriate to promulgate the standards contained in today's rule.

EPA notes that there may be some doubts as to whether the State of Washington would be able to adequately demonstrate its authority under State law to regulate activities affecting surface water quality on the Colville reservation in light of the relevant precedents regarding preemption of state regulatory authority on Indian lands.[2] As the commenter noted, the proper test for determining the extent of State regulatory authority was clearly stated by the Supreme Court in *Cabazon*.

> State jurisdiction is pre-empted * * * if it interferes or is incompatible with Federal and tribal interests reflected in Federal law unless the State interests at stake are sufficient to justify the assertion of State authority. The inquiry is to proceed in light of traditional notions of Indian self-government, including its overriding goal of encouraging tribal self-sufficiency and economic development.

Cabazon, 107 S.Ct. at 1092 (quoting *New Mexico v. Mescalero Apache Tribe*, 462 U.S. 324, 333–35 (1983)). EPA believes that the adoption of section 518 of the CWA evinces strong Congressional preference for Tribal

[1] A copy of both cooperative agreements is available in the docket for today's rule.

[2] EPA has also determined that the State of Washington cannot adequately demonstrate its authority to regulate hazardous waste activities and underground injection activities on Indian lands in the State, and has declined to authorize Washington to administer these programs on Indian lands. *See Washington Dept. of Ecology v. EPA*, 752 F.2d 1465 (9th Cir. 1985) (hazardous waste); 53 FR 42,080 (1988) (underground injection).

control of water quality on Indian reservations, where the Tribe meets the statutory criteria. Thus, the Federal interest in ensuring enforcement of tribal water quality standards is strong and the continued applicability of the State standards may be subject to question. However, in light of the fact that both the Tribe and the State have "plac[ed] environmental protection ahead of jurisdictional conflicts in developing the (tribal water quality management) plan," [3] EPA does not today attempt to finally resolve this question, nor does it feel that it must resolve this question before it can find that today's rule is necessary under section 303(c)(4)(B) of the CWA. Thus, EPA declines to do so.

Finally, this commenter argued that EPA may not promulgate these standards, since the Confederated Tribes of the Colville Reservation have not qualified to be treated as a State under section 518 of the CWA for purposes of developing water quality standards for EPA approval under section 303 of the CWA. EPA believes that the commenter may have misunderstood the statutory basis for today's action. Section 518(e) establishes statutory prerequisites that must be satisfied by a Tribe before it may submit water quality standards for approval by EPA under section 303. EPA is in the process of developing regulations to implement section 518 for purposes of the standards program, which it plans on proposing in the summer of 1989 for public comment. However, today's action is not an approval of Tribal standards under section 303(a)(3)(A), but Federal promulgation of standards under 303(c)(4)(B). Section 518 does not affect EPA's authority to promulgate Federal water quality standards.

The statutory context in which today's rule is adopted is very similar to the situation presented to the U.S. Court of Appeals in *Phillips Petroleum Co.* v. *EPA*, 803 F.2d 545 (10th Cir. 1986). In that case, Phillips challenged EPA's regulation promulgating a Federal Underground Injection Control (UIC) program under the Safe Drinking Water Act (SDWA) for the Osage Mineral Reserve. Phillips argued that EPA lacked the authority to promulgate such regulations prior to the 1986 SDWA Amendments, which explicitly authorized EPA to promulgate Federal UIC programs on Indian lands. The Tenth Circuit upheld EPA's regulations, stating that the strong national interest in applying SDWA regulatory standards "ocean to ocean" overcame Congress' failure to address the implenemtation of SDWA on Indian lands. *Id.*, at 553, 555–56. The Court also noted that its conclusion that "the SDWA empowered the EPA to prescribe regulations for Indian lands is also consistent with the presumption that Congress intends a general statute applying to all persons to include Indians and their property interests." *Id.* at 556. EPA believes that same logic applies to the CWA, both prior to and subsequent to the adoption of section 518.

EPA disagrees that today's action would be premature or inconsistent with the regulations to be developed under section 518. One commenter stated that adoption of section 518 supersedes EPA's 1984 Indian Policy statement and the cooperative agreements discussed above, which were adopted pursuant to the policy. EPA disagrees with this statement. Adoption of section 518 grew out of EPA's efforts to implement the CWA on Indian lands in a manner consistent with the 1984 policy. There is no legislative history to suggest Congress intended EPA to alter its 1984 policy; indeed it suggests the opposite. Furthermore, section 518(d) of the CWA explicitly authorizes States and Tribes to enter cooperative agreements "to jointly plan and administer the requirements of (the CWA)," precisely what the Tribe and the State have done.

EPA does not believe that today's action must wait for section 518 regulations to be finalized. The Confederated Tribes requested EPA to promulgate the Tribal water quality standards as Federal standards on February 7, 1986, nearly one year before passage of the Water Quality Act of 1987. EPA sees no reason to delay promulgation of this rule while regulations are developed under section 518. EPA notes that, in a draft of the regulations to be proposed under section 518 which has been made publicly available, Federal promulgation of standards on Indian lands is mentioned as one method of implementing the water quality standards program (although not the preferred method, as discussed above), where the Tribe is not yet able, or chooses not to qualify for treatment as a State and submit its own standards for approval. Consistent with the draft regulations, EPA believes that today's action is entirely consistent with section 518 of the CWA. EPA would also point out that if, after promulgation of the regulations authorizing Indian Tribes to develop water quality standards, the Confederated Tribes of the Colville reservation qualify for the standards program and submit standards which are approved by EPA, EPA will withdraw these Federal water quality standards at the Tribes' request.

One commenter noted that although a narrative toxics "free from" criterion was included in the proposal, numeric criteria were not, and recommended that EPA consider the fact that the State of Washington adopted numeric criteria for certain toxics in January, 1988, and propose to adopt equivalent critera for reservation/State boundary waters.

Although an agreement exists between the State and the Tribe to maintain consistent water quality standards on boundary waters, this agreement does not involve EPA. It is EPA's judgment that, at present, it is appropriate not to propose numeric toxics criteria for waters of the Colville reservation. A primary factor in this decision is that EPA knows of no toxic pollutant that can reasonably be expected to be interfering with designated uses of the reservation. The Colville Tribes report only one point source discharger on the reservation and no toxics discovered from that discharger. EPA is aware of no other source of toxics in the area. Given these circumstances, numeric criteria for CWA section 307(a) pollutants are not required by CWA section 303(c)(2)(B). Until the Tribes qualify for treatment as a State for purposes of the standards program, or until additional information substantiating the need for numeric toxics criteria leads EPA to adopt numeric toxics criteria, EPA believes it is sufficient for the Agency to use the Agency's 304(a) criteria guidance to implement the narrative toxics "free from" criterion in any situation that might arise concerning the discharge of toxics.

One commenter noted that EPA erroneously noted in the Preamble to the proposed rulemaking that the Colville Water Quality Standards Act was amended by resolution (#1985–20) after the August 28, 1985 EPA approval of the Colville Water Quality Management Program, when in fact the amendment occurred before such EPA approval. EPA acknowledges the error.

One commenter noted several differences between the standards adopted by the State of Washington and the proposal. First, the State standards use the fecal coliform organism as a bacterial indicator, instead of enterococcus as used in the proposal. Second, the proposed Class III (equivalent to State B waters) includes primary contact recreation as a

[3] *See* letter from Ernesta Barnes, Regional Administrator, Region X, to the Honorable Booth Gardner, Governor, State of Washington, August 28, 1985, a copy of which is in the docket for today's rule.

designated use, while State Class B does not. Third, the proposed Class III and IV have different oxygen criteria than equivalent State Class B and C.

With regard to the first difference, EPA uses enterococcus because research has established that it is a better indicator. EPA encourages the State to change its bacterial indicator to be consistent with EPA's section 304(a) guidance. With regard to the second difference, EPA has included primary contact recreation as a designated use in support of the fishable/swimmable goal of the Clean Water Act, and assumes that the State conducts Use Attainability Analyses during each triennial review to determine whether the primary contact recreation use is attainable in their Class B waters. With regard to the third difference, EPA has based the dissolved oxygen criteria on the 1986 dissolved oxygen criteria document, and encourages States to update their criteria to reflect the most recent aquatic effects research.

C. Changes to the Proposed Rule

On EPA's initiative, the definition of "Reservation" was changed in the final rule to be consistent with the statutory definition provided in section 518 of the CWA. Specifically, the definition of "Reservation" which appeared in the proposed rulemaking was expanded to also include the language which was used in defining "Federal Indian Reservation" in CWA section 518(h) (i.e., "Federal Indian Reservation" means all land within the limits of any Indian Reservation under the jurisdiction of the United States government, notwithstanding the issuance of any patent, and including rights-of-way running through the reservation). Since the definition of "reservation" in section 518(h) tracks the common definition of the term (see 18 U.S.C. 1151(a)), this change will have no substantive effect on the rule. The change is meant only as a clarification.

On EPA's initiative, paragraph (c)(2) was re-written to be consistent with the requirements of § 131.13 of the water quality standards regulation. Section 131.13 authorizes the States to adopt general policies affecting the application of their water quality standards such as mixing zone, variance, and low-flow policies, but only if such policies are included as a part of the State's water quality standards. Proposed paragraph (c)(2), however, would have allowed the Regional Administrator to implement such general policies without including such policies in § 131.35. The new paragraph (c)(2) establishes a mixing zone policy in § 131.35, consistent with § 131.13, which authorizes the Regional Administrator to designate mixing zones, provided that such mixing zones are consistent with the most current EPA mixing zone guidelines in the Water Quality Standards Handbook and the Technical Support Document for Water Quality Based Toxics Control. EPA notes that a low-flow policy was already included in proposed paragraph (c)(6). At this time, EPA declines to establish a variance policy in § 131.35.

On EPA's initiative, the definition of "Acute toxicity" was changed in the final rule to be more consistent with the definition of "acute" in EPA's Technical Support Document for Water Quality Based Toxics Control. The proposed definition limited acutely toxics effects only to mortality and the period of exposure only to 96 hours.

D. Regulatory Flexibility Act

Under the Regulatory Flexibility Act, 5 U.S.C. 601 *et seq.*, EPA must prepare a Regulatory Flexibility Analysis for all proposed regulations that have a significant impact on a substantial number of small entities. EPA has determined that, because a Tribal regulation is already in place which is essentially equivalent in stringency to this rule, this Rule will not have significant adverse impact on small entities.

E. Executive Order 12291

Under Executive Order 12291, EPA must judge whether a regulation is "major" and therefore subject to the requirement of preparing a Regulatory Impact Analysis. A major rule is defined as a regulation which is likely to result in:

(1) An annual effect on the economy of $100 million or more;

(2) A major increase in costs or prices for consumers; individual industries; Federal, State, and local government agencies; or geographic regions; or

(3) Significant adverse effect on competition, employment, investment, productivity, innovation, or the ability of United States-based enterprises to compete with foreign-based enterprises in domestic or export markets.

EPA has determined that this rule does not meet the definition of a major regulation; therefore, no Regulatory Impact Analysis is required. Also, as required by Executive Order 12291 this rule has been reviewed by the Office of Management and Budget (OMB). Any written comments from OMB to EPA and any response to those comments are available for public inspection through contacting the person listed at the beginning of this notice.

F. Paperwork Reduction Act

Promulgation of Federal water quality standards was one of the actions contemplated under the water quality standards regulation, which is covered by ICR # 2040–0049 approved by OMB. Since there are no significant additional information collection provisions in this rule, there is no requirement for approval of an additional ICR by OMB for the Paperwork Reduction Act of 1980.

G. List of Subjects in 40 CFR Part 131

Indian Reservation water quality standards, Water pollution control, Water quality standards.

Date: June 23, 1989.

William K. Reilly,

Administrator.

For the reasons set out in the SUPPLEMENTARY INFORMATION section, Part 131 of the Title 40 of the Code of Federal Regulations is amended as follows:

PART 131—WATER QUALITY STANDARDS

1. The authority citation for Part 131 continues to read as follows:

Authority: Clean Water Act, P.L. 92–500, as amended; 33 U.S.C. 1251 et seq.

2. Section 131.35 is added to read as follows:

§ 131.35 Colville Confederated Tribes Indian Reservation.

The water quality standards applicable to the waters within the Colville Indian Reservation, located in the State of Washington.

(a) *Background.* (1) It is the purpose of these Federal water quality standards to prescribe minimum water quality requirements for the surface waters located within the exterior boundaries of the Colville Indian Reservation to ensure compliance with section 303(c) of the Clean Water Act.

(2) The Colville Confederated Tribes have a primary interest in the protection, control, conservation, and utilization of the water resources of the Colville Indian Reservation. Water quality standards have been enacted into tribal law by the Colville Business Council of the Confederated Tribes of the Colville Reservation, as the Colville Water Quality Standards Act, CTC Title 33 (Resolution No. 1984–526 (August 6, 1984) as amended by Resolution No. 1985–20 (January 18, 1985)).

(b) *Territory Covered.* The provisions of these water quality standards shall apply to all surface waters within the

exterior boundaries of the Colville Indian Reservation.

(c) *Applicability, Administration and Amendment.* (1) The water quality standards in this section shall be used by the Regional Administrator for establishing any water quality based National Pollutant Discharge Elimination System Permit (NPDES) for point sources on the Colville Confederated Tribes Reservation.

(2) In conjunction with the issuance of section 402 or section 404 permits, the Regional Administrator may designate mixing zones in the waters of the United States on the reservation on a case-by-case basis. The size of such mixing zones and the in-zone water quality in such mixing zones shall be consistent with the applicable procedures and guidelines in EPA's Water Quality Standards Handbook and the Technical Support Document for Water Quality Based Toxics Control.

(3) Amendments to the section at the request of the Tribe shall proceed in the following manner.

(i) The requested amendment shall first be duly approved by the Confederated Tribes of the Colville Reservation (and so certified by the Tribes Legal Counsel) and submitted to the Regional Administrator.

(ii) The requested amendment shall be reviewed by EPA (and by the State of Washington, if the action would affect a boundary water).

(iii) If deemed in compliance with the Clean Water Act, EPA will propose and promulgate an appropriate change to this section.

(4) Amendment of this section at EPA's initiative will follow consultation with the Tribe and other appropriate entities. Such amendments will then follow normal EPA rulemaking procedures.

(5) All other applicable provisions of this Part 131 shall apply on the Colville Confederated Tribes Reservation. Special attention should be paid to §§ 131.6, 131.10, 131.11 and 131.20 for any amendment to these standards to be initiated by the Tribe.

(6) All numeric criteria contained in this section apply at all in-stream flow rates greater than or equal to the flow rate calculated as the minimum 7-consecutive day average flow with a recurrence frequency of once in ten years (7Q10); narrative criteria (§ 131.35(e)(3)) apply regardless of flow. The 7Q10 low flow shall be calculated using methods recommended by the U.S. Geological Survey.

(d) *Definitions.* (1) "Acute toxicity" means a deleterious response (e.g., mortality, disorientation, immobilization) to a stimulus observed in 96 hours or less.

(2) "Background conditions" means the biological, chemical, and physical conditions of a water body, upstream from the point or non-point source discharge under consideration. Background sampling location in an enforcement action will be upstream from the point of discharge, but not upstream from other inflows. If several discharges to any water body exist, and an enforcement action is being taken for possible violations to the standards, background sampling will be undertaken immediately upstream from each discharge.

(3) "Ceremonial and Religious water use" means activities involving traditional Native American spiritual practices which involve, among other things, primary (direct) contact with water.

(4) "Chronic Toxicity" means the lowest concentration of a constituent causing observable effects (i.e., considering lethality, growth, reduced reproduction, etc.) over a relatively long period of time, usually a 28-day test period for small fish test species.

(5) "Council" or "Tribal Council" means the Colville Business Council of the Colville Confederated Tribes.

(6) "Geometric mean" means the "nth" root of a product of "n" factors.

(7) "Mean retention time" means the time obtained by dividing a reservoir's mean annual minimum total storage by the non-zero 30-day, ten-year low-flow from the reservoir.

(8) "Mixing Zone" or "dilution zone" means a limited area or volume of water where initial dilution of a discharge takes place; and where numeric water quality criteria can be exceeded but acutely toxic conditions are prevented from occurring.

(9) "pH" means the negative logarithm of the hydrogen ion concentration.

(10) "Primary contact recreation" means activities where a person would have direct contact with water to the point of complete submergence, including but not limited to skin diving, swimming, and water skiing.

(11) "Regional Administrator" means the Administrator of EPA's Region X.

(12) "Reservation" means all land within the limits of the Colville Indian Reservation, established on July 2, 1872 by Executive Order, presently containing 1,389,000 acres more or less, and under the jurisdiction of the United States government, notwithstanding the issuance of any patent, and including rights-of-way running through the reservation.

(13) "Secondary contact recreation" means activities where a person's water contact would be limited to the extent that bacterial infections of eyes, ears, respiratory, or digestive systems or urogenital areas would normally be avoided (such as wading or fishing).

(14) "Surface water" means all water above the surface of the ground within the exterior boundaries of the Colville Indian Reservation including but not limited to lakes, ponds, reservoirs, artificial impoundments, streams, rivers, springs, seeps and wetlands.

(15) "Temperature" means water temperature expressed in Centigrade degrees (C).

(16) "Total dissolved solids" (TDS) means the total filterable residue that passes through a standard glass fiber filter disk and remains after evaporation and drying to a constant weight at 180 degrees C. it is considered to be a measure of the dissolved salt content of the water.

(17) "Toxicity" means acute and/or chronic toxicity.

(18) "Tribe" or "Tribes" means the Colville Confederated Tribes.

(19) "Turbidity" means the clarity of water expressed as nephelometric turbidity units (NTU) and measured with a calibrated turbidimeter.

(20) "Wildlife habitat" means the waters and surrounding land areas of the Reservation used by fish, other aquatic life and wildlife at any stage of their life history or activity.

(e) *General considerations.* The following general guidelines shall apply to the water quality standards and classifications set forth in the use designation Sections.

(1) *Classification Boundaries.* At the boundary between waters of different classifications, the water quality standards for the higher classification shall prevail.

(2) *Antidegradation Policy.* This antidegradation policy shall be applicable to all surface waters of the Reservation.

(i) Existing in-stream water uses and the level of water quality necessary to protect the existing uses shall be maintained and protected.

(ii) Where the quality of the waters exceeds levels necessary to support propagation of fish, shellfish, and wildlife and recreation in and on the water, that quality shall be maintained and protected unless the Regional Administrator finds, after full satisfaction of the inter-governmental coordination and public participation provisions of the Tribes' continuing planning process, that allowing lower water quality is necessary to accommodate important economic or social development in the area in which

the waters are located. In allowing such degradation or lower water quality, the Regional Administrator shall assure water quality adequate to protect existing uses fully. Further, the Regional Administrator shall assure that there shall be achieved the highest statutory and regulatory requirements for all new and existing point sources and all cost-effective and reasonable best management practices for nonpoint source control.

(iii) Where high quality waters are identified as constituting an outstanding national or reservation resource, such as waters within areas designated as unique water quality management areas and waters otherwise of exceptional recreational or ecological significance, and are designated as special resource waters, that water quality shall be maintained and protected.

(iv) In those cases where potential water quality impairment associated with a thermal discharge is involved, this antidegradation policy's implementing method shall be consistent with section 316 of the Clean Water Act.

(3) *Aesthetic Qualities.* All waters within the Reservation, including those within mixing zones, shall be free from substances, attributable to wastewater discharges or other pollutant sources, that:

(i) Settle to form objectionable deposits;

(ii) Float as debris, scum, oil, or other matter forming nuisances;

(iii) Produce objectionable color, odor, taste, or turbidity;

(iv) Cause injury to, are toxic to, or produce adverse physiological responses in humans, animals, or plants; or

(v) produce undesirable or nuisance aquatic life.

(4) *Analytical Methods.* (i) The analytical testing methods used to measure or otherwise evaluate compliance with water quality standards shall to the extent practicable, be in accordance with the "Guidelines Establishing Test Procedures for the Analysis of Pollutants" (40 CFR Part 136). When a testing method is not available for a particular substance, the most recent edition of "Standard Methods for the Examination of Water and Wastewater" (published by the American Public Health Association, American Water Works Association, and the Water Pollution Control Federation) and other or superseding methods published and/or approved by EPA shall be used.

(f) *General Water Use and Criteria Classes.* The following criteria shall apply to the various classes of surface waters on the Colville Indian Reservation:

(1) *Class I (Extraordinary)*—(i) *Designated uses.* The designated uses include, but are not limited to, the following:

(A) Water supply (domestic, industrial, agricultural).

(B) Stock watering.

(C) Fish and shellfish: Salmonid migration, rearing, spawning, and harvesting; other fish migration, rearing, spawning, and harvesting.

(D) Wildlife habitat.

(E) Ceremonial and religious water use.

(F) Recreation (primary contact recreation, sport fishing, boating and aesthetic enjoyment).

(G) Commerce and navigation.

(ii) *Water quality criteria.* (A) Bacteriological Criteria. The geometric mean of the enterococci bacteria densities in samples taken over a 30 day period shall not exceed 8 per 100 milliliters, nor shall any single sample exceed an enterococci density of 35 per 100 milliliters. These limits are calculated as the geometric mean of the collected samples approximately equally spaced over a thirty day period.

(B) Dissolved oxygen—The dissolved oxygen shall exceed 9.5 mg/l.

(C) Total dissolved gas—concentrations shall not exceed 110 percent of the saturation value for gases at the existing atmospheric and hydrostatic pressures at any point of sample collection.

(D) Temperature—shall not exceed 16.0 degrees C due to human activities. Temperature increases shall not, at any time, exceed $t=23/(T+5)$.

(*1*) When natural conditions exceed 16.0 degrees C, no temperature increase will be allowed which will raise the receiving water by greater than 0.3 degrees C.

(*2*) For purposes hereof, "t" represents the permissive temperature change across the dilution zone; and "T" represents the highest existing temperature in this water classification outside of any dilution zone.

(*3*) Provided that temperature increase resulting from nonpoint source activities shall not exceed 2.8 degrees C, and the maximum water temperature shall not exceed 10.3 degrees C.

(E) pH shall be within the range of 6.5 to 8.5 with a human-caused variation of less than 0.2 units.

(F) Turbidity shall not exceed 5 NTU over background turbidity when the background turbidity is 50 NTU or less, or have more than a 10 percent increase in turbidity when the background turbidity is more than 50 NTU.

(G) Toxic, radioactive, nonconventional, or deleterious material concentrations shall be less than those of public health significance, or which may cause acute or chronic toxic conditions to the aquatic biota, or which may adversely affect designated water uses.

(2) *Class II (Excellent).*—(i) *Designated uses.* The designated uses include but are not limited to, the following:

(A) Water supply (domestic, industrial, agricultural).

(B) Stock watering.

(C) Fish and shellfish: Salmonid migration, rearing, spawning, and harvesting; other fish migration, rearing, spawning, and harvesting; crayfish rearing, spawning, and harvesting.

(D) Wildlife habitat.

(E) Ceremonial and religious water use.

(F) Recreation (primary contact recreation, sport fishing, boating and aesthetic enjoyment).

(G) Commerce and navigation.

(ii) *Water quality criteria.* (A) Bacteriological Criteria—The geometric mean of the enterococci bacteria densities in samples taken over a 30 day period shall not exceed 16/100 ml, nor shall any single sample exceed an enterococci density of 75 per 100 milliliters. These limits are calculated as the geometric mean of the collected samples approximately equally spaced over a thirty day period.

(B) Dissolved oxygen—The dissolved oxygen shall exceed 8.0 mg/l.

(C) Total dissolved gas—concentrations shall not exceed 110 percent of the saturation value for gases at the existing atmospheric and hydrostatic pressures at any point of sample collection.

(D) Temperature-shall not exceed 18.0 degrees C due to human activities. Temperature increases shall not, at any time, exceed $t=28/(T+7)$.

(*1*) When natural conditions exceed 18 degrees C no temperature increase will be allowed which will raise the receiving water temperature by greater than 0.3 degrees C.

(*2*) For purposes hereof, "t" represents the permissive temperature change across the dilution zone; and "T" represents the highest existing temperature in this water classification outside of any dilution zone.

(*3*) Provided that temperature increase resulting from non-point source activities shall not exceed 2.8 degrees C, and the maximum water temperature shall not exceed 18.3 degrees C.

(E) pH shall be within the range of 6.5 to 8.5 with a human-caused variation of less than 0.5 units.

(F) Turbidity shall not exceed 5 NTU over background turbidity when the background turbidity is 50 NTU or less, or have more than a 10 percent increase in turbidity when the background turbidity is more than 50 NTU.

(G) Toxic, radioactive, nonconventional, or deleterious material concentrations shall be less than those of public health significance, or which may cause acute or chronic toxic conditions to the aquatic biota, or which may adversely affect designated water uses.

(3) *Class III (Good).*—(i) *Designated uses.* The designated uses include but are not limited to, the following:

(A) Water supply (industrial, agricultural).

(B) Stock watering.

(C) Fish and shellfish: Salmonid migration, rearing, spawning, and harvesting; other fish migration, rearing, spawning, and harvesting; crayfish rearing, spawning, and harvesting.

(D) Wildlife habitat.

(E) Recreation (secondary contact recreation, sport fishing, boating and aesthetic enjoyment).

(F) Commerce and navigation.

(ii) *Water quality criteria.* (A) Bacteriological Criteria—The geometric mean of the enterococci bacteria densities in samples taken over a 30 day period shall not exceed 33/100 ml, nor shall any single sample exceed an enterococci density of 150 per 100 milliliters. These limits are calculated as the geometric mean of the collected samples approximately equally spaced over a thirty day period.

(B) Dissolved oxygen.

	Early life stages [1,2]	Other life stages
7 day mean	9.5 (6.5)	[3] NA
1 day minimum [4]	8.0 (5.0)	6.5

[1] These are water column concentrations recommended to achieve the required intergravel dissolved oxygen concentrations shown in parentheses. The 3 mg/L differential is discussed in the dissolved oxygen criteria document (EPA 440/5-86-003, April 1986). For species that have early life stages exposed directly to the water column, the figures in parentheses apply.

[2] Includes all embryonic and larval stages and all juvenile forms to 30-days following hatching.

[3] NA (not applicable)

[4] All minima should be considered as instantaneous concentrations to be achieved at all times.

(C) Total dissolved gas concentrations shall not exceed 110 percent of the saturation value for gases at the existing atmospheric and hydrostatic pressures at any point of sample collection.

(D) Temperature shall not exceed 21.0 degrees C due to human activities. Temperature increases shall not, at any time, exceed $t=34/(T+9)$.

(*1*) When natural conditions exceed 21.0 degrees C no temperature increase will be allowed which will raise the receiving water temperature by greater than 0.3 degrees C.

(*2*) For purposes hereof, "t" represents the permissive temperature change across the dilution zone; and "T" represents the highest existing temperature in this water classification outside of any dilution zone.

(*3*) Provided that temperature increase resulting from nonpoint source activities shall not exceed 2.8 degrees C, and the maximum water temperature shall not exceed 21.3 degrees C.

(E) pH shall be within the range of 6.5 to 8.5 with a human-caused variation of less than 0.5 units.

(F) Turbidity shall not exceed 10 NTU over background turbidity when the background turbidity is 50 NTU or less, or have more than a 20 percent increase in turbidity when the background turbidity is more than 50 NTU.

(G) Toxic, radioactive, nonconventional, or deleterious material concentrations shall be less than those of public health significance, or which may cause acute or chronic toxic conditions to the aquatic biota, or which may adversely affect designated water uses.

(4) *Class IV (Fair)*—(i) *Designated uses.* The designated uses include but are not limited to, the following:

(A) Water supply (industrial).

(B) Stock watering.

(C) Fish (salmonid and other fish migration).

(D) Recreation (secondary contact recreation, sport fishing, boating and aesthetic enjoyment).

(E) Commerce and navigation.

(ii) *Water quality criteria.* (A) Dissolved oxygen.

	During periods of salmonid and other fish migration	During all other time periods
30 day mean	6.5	5.5
7 day mean	[1] NA	[1] NA
7 day mean minimum	5.0	4.0
1 day minimum [2]	4.0	3.0

[1] NA (not applicable).

[2] All minima should be considered as instantaneous concentrations to be achieved at all times.

(B) Total dissolved gas—concentrations shall not exceed 110 percent of the saturation value for gases at the existing atmospheric and hydrostatic pressures at any point of sample collection.

(C) Temperature shall not exceed 22.0 degrees C due to human activities. Temperature increases shall not, at any time, exceed $t=20/(T+2)$.

(*1*) When natural conditions exceed 22.0 degrees C, no temperature increase will be allowed which will raise the receiving water temperature by greater than 0.3 degrees C.

(*2*) For purposes hereof, "t" represents the permissive temperature change across the dilution zone; and "T" represents the highest existing temperature in this water classification outside of any dilution zone.

(D) pH shall be within the range of 6.5 to 9.0 with a human-caused variation of less than 0.5 units.

(E) Turbidity shall not exceed 10 NTU over background turbidity when the background turbidity is 50 NTU or less, or have more than a 20 percent increase in turbidity when the background turbidity is more than 50 NTU.

(F) Toxic, radioactive, nonconventional, or deleterious material concentrations shall be less than those of public health significance, or which may cause acute or chronic toxic conditions to the aquatic biota, or which may adversely affect designated water uses.

(5) *Lake Class*—(i) *Designated uses.* The designated uses include but are not limited to, the following:

(A) Water supply (domestic, industrial, agricultural).

(B) Stock watering.

(C) Fish and shellfish: Salmonid migration, rearing, spawning, and harvesting; other fish migration, rearing, spawning, and harvesting; crayfish rearing, spawning, and harvesting.

(D) Wildlife habitat.

(E) Ceremonial and religious water use.

(F) Recreation (primary contact recreation, sport fishing, boating and aesthetic enjoyment).

(G) Commerce and navigation.

(ii) *Water quality criteria.* (A) Bacteriological Criteria. The geometric mean of the enterococci bacteria densities in samples taken over a 30 day period shall not exceed 33/100 ml, nor shall any single sample exceed an enterococci density of 150 per 100 milliliters. These limits are calculated as the geometric mean of the collected samples approximately equally spaced over a thirty day period.

(B) Dissolved oxygen—no measurable decrease from natural conditions.

(C) Total dissolved gas concentrations shall not exceed 110 percent of the saturation value for gases at the existing atmospheric and hydrostatic pressures at any point of sample collection.

(D) Temperature—no measurable change from natural conditions.

(E) pH—no measurable change from natural conditions.

(F) Turbidity shall not exceed 5 NTU over natural conditions.

(G) Toxic, radioactive, nonconventional, or deleterious material concentrations shall be less than those which may affect public health, the natural aquatic environment, or the desirability of the water for any use.

(6) *Special Resource Water Class (SRW)*—(i) *General characteristics.* These are fresh or saline waters which comprise a special and unique resource to the Reservation. Water quality of this class will be varied and unique as determined by the Regional Administrator in cooperation with the Tribes.

(ii) *Designated uses.* The designated uses include, but are not limited to, the following:

(A) Wildlife habitat.

(B) Natural foodchain maintenance.

(iii) Water quality criteria.

(A) Enterococci bacteria densities shall not exceed natural conditions.

(B) Dissolved oxygen—shall not show any measurable decrease from natural conditions.

(C) Total dissolved gas shall not vary from natural conditions.

(D) Temperature—shall not show any measurable change from natural conditions.

(E) pH shall not show any measurable change from natural conditions.

(F) Settleable solids shall not show any change from natural conditions.

(G) Turbidity shall not exceed 5 NTU over natural conditions.

(H) Toxic, radioactive, or deleterious material concentrations shall not exceed those found under natural conditions.

(g) *General Classifications.* General classifications applying to various surface waterbodies not specifically classified under § 131.35(h) are as follows:

(1) All surface waters that are tributaries to Class I waters are classified Class I, unless otherwise classified.

(2) Except for those specifically classified otherwise, all lakes with existing average concentrations less than 2000 mg/L TDS and their feeder streams on the Colville Indian Reservation are classified as Lake Class and Class I, respectively.

(3) All lakes on the Colville Indian Reservation with existing average concentrations of TDS equal to or exceeding 2000 mg/L and their feeder streams are classified as Lake Class and Class I respectively unless specifically classified otherwise.

(4) All reservoirs with a mean detention time of greater than 15 days are classified Lake Class.

(5) All reservoirs with a mean detention time of 15 days or less are classified the same as the river section in which they are located.

(6) All reservoirs established on pre-existing lakes are classified as Lake Class.

(7) All wetlands are assigned to the Special Resource Water Class.

(8) All other waters not specifically assigned to a classification of the reservation are classified as Class II.

(h) *Specific Classifications.* Specific classifications for surface waters of the Colville Indian Reservation are as follows:

(1) Streams:	
Alice Creek	Class III
Anderson Creek	Class III
Armstrong Creek	Class III
Barnaby Creek	Class II
Bear Creek	Class III
Beaver Dam Creek	Class II
Bridge Creek	Class II
Brush Creek	Class III
Buckhorn Creek	Class III
Cache Creek	Class III
Canteen Creek	Class I
Capoose Creek	Class III
Cobbs Creek	Class III
Columbia River from Chief Joseph Dam to Wells Dam.	
Columbia River from northern Reservation boundary to Grand Coulee Dam (Roosevelt Lake).	
Columbia River from Grand Coulee Dam to Chief Joseph Dam.	
Cook Creek	Class I
Cooper Creek	Class III
Cornstalk Creek	Class III
Cougar Creek	Class I
Coyote Creek	Class II
Deerhorn Creek	Class III
Dick Creek	Class III
Dry Creek	Class I
Empire Creek	Class III
Faye Creek	Class I
Forty Mile Creek	Class III
Gibson Creek	Class I
Gold Creek	Class II
Granite Creek	Class II
Grizzly Creek	Class III
Haley Creek	Class III
Hall Creek	Class II
Hall Creek, West Fork	Class I
Iron Creek	Class III
Jack Creek	Class III
Jerred Creek	Class I
Joe Moses Creek	Class III
John Tom Creek	Class III
Jones Creek	Class I
Kartar Creek	Class III
Kincaid Creek	Class III
King Creek	Class III
Klondyke Creek	Class I
Lime Creek	Class III
Little Jim Creek	Class III
Little Nespelem	Class II
Louie Creek	Class III
Lynx Creek	Class II
Manila Creek	Class III
McAllister Creek	Class III
Meadow Creek	Class III
Mill Creek	Class II
Mission Creek	Class III
Nespelem River	Class II
Nez Perce Creek	Class III
Nine Mile Creek	Class II
Nineteen Mile Creek	Class III
No Name Creek	Class II
North Nanamkin Creek	Class III
North Star Creek	Class III
Okanogan River from Reservation north boundary to Columbia River.	Class II
Olds Creek	Class I
Omak Creek	Class II
Onion Creek	Class II
Parmenter Creek	Class III
Peel Creek	Class III
Peter Dan Creek	Class III
Rock Creek	Class I
San Poil River	Class I
Sanpoil, River West Fork.	Class II
Seventeen Mile Creek	Class III
Silver Creek	Class III
Sitdown Creek	Class III
Six Mile Creek	Class III
South Nanamkin Creek	Class III
Spring Creek	Class III
Stapaloop Creek	Class III
Stepstone Creek	Class III
Stranger Creek	Class II
Strawberry Creek	Class III
Swimptkin Creek	Class III
Three Forks Creek	Class I
Three Mile Creek	Class III
Thirteen Mile Creek	Class II
Thirty Mile Creek	Class II
Trail Creek	Class III
Twentyfive Mile Creek	Class III
Twentyone Mile Creek	Class III
Twentythree Mile Creek	Class III
Wannacot Creek	Class III
Wells Creek	Class I
Whitelaw Creek	Class III
Wilmont Creek	Class II
(2) Lakes:	
Apex Lake	LC
Big Goose Lake	LC
Bourgeau Lake	LC
Buffalo Lake	LC
Cody Lake	LC
Crawfish Lakes	LC
Camille Lake	LC
Elbow Lake	LC
Fish Lake	LC
Gold Lake	LC
Great Western Lake	LC
Johnson Lake	LC
LaFleur Lake	LC
Little Goose Lake	LC
Little Owhi Lake	LC
McGinnis Lake	LC
Nicholas Lake	LC
Omak Lake	SRW
Owhi Lake	SRW
Penley Lake	SRW
Rebecca Lake	LC
Round Lake	LC
Simpson Lake	LC
Soap Lake	LC
Sugar Lake	LC
Summit Lake	LC
Twin Lakes	SRW

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